The Economist

FEBRUARY 12TH–18TH 2005 www.economist.com

Wrong about immigration
PAGES 15 AND 27

Spain and the Basques
PAGE 35

Nokia's turnaround
PAGES 71-73

Corporate profits at a record high
PAGES 14 AND 66

Together to the promised land

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters
WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide
SURVEYS
BUSINESS
Management Reading
Business Education
Executive Dialogue
FINANCE & ECONOMICS
Economics Focus
Economics A-Z
SCIENCE & TECHNOLOGY
Technology Quarterly
PEOPLE
Obituary
BOOKS & ARTS
Catch if you can
Style Guide
MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index
DIVERSIONS
RESEARCH TOOLS
CLASSIFIEDS
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Print Edition February 12th 2005

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Feb 5th 2005
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The world this week

Politics this week
Business this week

Leaders

Israel and the Palestinians
Together to the promised land

America's pensions
How to mend Social Security

The drug "war" in Latin America
Next steps in Colombia

Aid, debt and development
Show us the money

Corporate profits
Breaking records

Immigration in Britain
After the flood

Letters

On Iraq, Nazi symbols, free speech, copyright, CSR, alcohol, France, the UN, tort reform

Special Report

The north Caucasus
An empire's fraying edge

The south Caucasus
Murky

United States

Reshaping Social Security and the budget
Escaping the shadow of a reckless past

Other countries' pension policies
Horror movies? Not really

Social attitudes
Not quite right

Chicago
Has young Daley got the point?

Gay marriage in New York
No, but maybe yes

Covenant marriages in Arkansas
Yes, I really do

Lexington
From Bill to Howard

The Americas

Drugs in Latin America
Battles won, a war still lost

Drugs in Canada
Under the needle

Suriname
A lingua franca for a tropical babel

State elections in Mexico
The waiters' revolt

Asia

Dealing with North Korea, again
When the partying has to stop

Japan and North Korea
The dear cheerleader

Thailand

Business

Hewlett-Packard
Exit Carly

Unilever
Slim fast

Anglo-Dutch companies
From rivalry to mergers

Tobacco litigation
Smokin'

Biotechnology
The triumph of the commons

Corporate performance
A world awash with profits

Energy in Africa
To Libya and beyond

Face value
Chief humanising officer

Special Report

Nokia's turnaround
The giant in the palm of your hand

Finance & Economics

The G7, aid and debt
They have willed the ends, but what about the means?

The Economist's commodity-price index
160 years on

Commodities
A certain shine

Euronext and the LSE
Priceless

Investing in Russia
Forgive and forget?

European bonds
The market and Methuselah

Executive Life
Heading for court

Riggs National and PNC
A deal of trouble

Economics focus
Sheltered market

Science & Technology

Computing
The cell of a new machine

Data storage
Shaken, not stirred

Scientific publishing
Who pays the piper...

Animal behaviour
Love me, love my dog

The Richard Casement internship

Books & Arts

Afghanistan
Time for tea and ambushes

India
A $50 billion bonanza

Myanmar
One last harvest

Middle East & Africa

Israel and Palestine
Peace in our time?

Iraq's election
Sectarian riddles

Saudi Arabia
Shifting sands

The UN's oil-for-food scandal
Something rotten

Togo
Eyadéma's woeful legacy

Corruption in Kenya
Feet of Clay

Europe

Spain and the Basques
Independence days

France's 35-hour week
Hollow protests

France and America
Condi's charm offensive

Catholics and Muslims
Awkward partners

Dresden 60 years on
Misusing the memory

Tax in central Europe
Too high everywhere

Charlemagne
The great debate begins

Britain

Immigration
Rolling up the welcome mat

Equities
Unhappy returns

Charles and Camilla
The prince's great matter

Freedom of information
The shoe pinches

Sailing
Around the world in 71 days

Road pricing
Crawling traffic

Local government
Who knows best?

Marketing Luton
Hard sell

Bagehot
Lessons from Maggie

The battle of Waterloo
Beating Boney

The Erie canal
Waters of wealth

Popular science
Power to the people

New fiction: Dean Bakopoulos
Our fathers

New fiction: John Updike
Too tired to

The Caucasus
Unreal city

Installation art
Gold sheer

Obituary

Obituary
Ernst Mayr

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Economic forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

The Economist commodity-price index

Emerging-Market Indicators

Overview

Exchange rates against the dollar

Economy

Financial markets

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Jobs
LEADER OF COUNTRY STRATEGY PROGRAM In Nigeria (Ref # 05-156) IFPRI is an....

Business / Consumer
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Tenders
GLOBAL INVITATION FOR EXPRESSION ....

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Politics this week

Feb 10th 2005
From The Economist print edition

Peace in our time?

AFP

Israel's prime minister, Ariel Sharon, and the **Palestinians'** newly elected president, Mahmoud Abbas, shook hands in the Egyptian resort of Sharm el-Sheikh and promised to end all attacks on one another. The Islamist group, Hamas, said it was not bound by the ceasefire and fired rockets at an Israeli settlement in Gaza.

See article

Condoleezza Rice, America's new secretary of state, conducted a whirlwind tour that included meetings with Mr Sharon in Jerusalem and Mr Abbas in Ramallah. Ms Rice also went to several European capitals, and called for a “new chapter” in transatlantic relations in a speech in Paris.

See article

For the first time, **Saudis** (men only) voted for a multiplicity of candidates for town councils in their capital, Riyadh, and in the surrounding province. It was the first of a series of local elections to be held across the country.

See article

President Gnassingbé Eyadéma of **Togo**, Africa's longest-serving ruler, having taken power in a coup in 1967, died en route for medical treatment in France. His son Faure Gnassingbé emulated his father by promptly launching a coup himself, over the objections of several African leaders.

See article

Somalia's new government, which has not yet dared set foot in the chaotic country it nominally rules, said it would go there on February 21st, so long as donors pay for peacekeeping. One of Somalia's warlords vowed to kill any foreign troops who tried to impose order. Meanwhile a BBC journalist was murdered in Mogadishu, the capital.

John Githongo, a **Kenyan** entrusted by the government with rooting out corruption, fled into exile. Western ambassadors deplored the government's failure to clean things up.

See article

After meeting in London, the finance ministers of the G7 countries said they would formally work towards relieving 100% of **debt** owed by the world's poorest countries, most of which are in

Africa. One idea floated was for the IMF to sell some of its gold reserves to help fund debt relief. All will be discussed at a G7 meeting in April.

See article

Legislating for peace

Meeting in Cartagena, aid donors refused to provide money for a peace deal between **Colombia's** government and right-wing paramilitaries. They said the country's legislature should first approve a bill to ensure that the vigilantes confess their crimes and dismantle their drug-trafficking organisations.

See article

In a gubernatorial election in the state of Guerrero, **Mexico's** main opposition party, the formerly ruling Institutional Revolutionary Party, suffered a shock defeat at the hands of the leftish Party of the Democratic Revolution (PRD). The result boosts the chances of Andrés Manuel López Obrador, the PRD's standard bearer, in next year's presidential vote.

See article

Cuba, which is synonymous with cigars, banned smoking in public places. Initial reports said many Cubans carried on puffing regardless.

In **Canada**, an inquiry into a scandal involving the siphoning of funds from a federal-government marketing campaign in Quebec questioned Jean Chrétien, the former prime minister. He defended the campaign as necessary to defeat Quebec separatism; he implied that Paul Martin, his rival and successor who was to testify later, knew more of the details.

AP

North Korea's bombshell

North Korea said it is suspending its participation in diplomatic talks over its nuclear programme, because America had called it an “outpost of tyranny”.

See article

Thailand's prime minister, Thaksin Shinawatra, was re-elected by a landslide—the first outright party victory in Thailand's democratic history.

See article

More than 50 people were reported killed in an outbreak of fighting on the island of Jolo in the southern **Philippines**.

Telephone connections were restored to **Nepal**, a week after the king staged a coup, dismissing his own government. The mobile-phone network stayed switched off.

Benazir Bhutto's husband, Asif Zardari, who was released from prison in **Pakistan** last year, filed

lawsuits against the government, alleging he was tortured.

Drugs money

Democrats in Congress asked for an inquiry into higher estimates on the cost of the new **Medicare** prescription-drug benefit. A new forecast from the programme's administrator more than doubled the cost that was initially provided to Congress when it passed the law two years ago.

George Bush's senior political adviser at the White House, **Karl Rove**, was promoted to deputy chief-of-staff. Mr Rove is widely credited with steering Mr Bush to victory in both 2000 and 2004. The move means he now officially helps co-ordinate policy.

Mike DeWine, a Republican senator from Ohio, said that the CIA had agreed to release further documents on its hiring of **Nazi war criminals** during the cold war. The CIA has released over 1m pages, but held back files that it said might harm its sources.

Paul Shanley was convicted of sexually abusing a young boy in the 1980s. The trial of the former **Boston** priest, who is 74, could lead to more cases against clergymen.

The iron lady

After **Ukraine's** parliament had confirmed Yulia Timoshenko as prime minister, her new government announced that it would re-privatise the Kryvorizhstal steelworks, controversially sold by the previous regime.

France's National Assembly defied thousands of street protesters by softening the terms of the 35-hour working week. But it left the symbolic ceiling of 35 hours in place in its new law.

AP

See article

As expected, **Denmark's** centre-right prime minister comfortably won the general election. He and his allies will have 95 of the 179 parliamentary seats. The Social Democrats did less badly than some had feared, but their leader still resigned.

A car bomb planted by the **Basque** terrorist group ETA exploded in Madrid, wounding over 40 people. It was the city's first big terrorist attack since the train bombings of last March.

See article

Spain's government announced an amnesty for the country's estimated 1m illegal immigrants.

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Business this week

Feb 10th 2005
From The Economist print edition

Exit Carly

Hewlett-Packard's CEO and chairman, **Carly Fiorina**, unexpectedly stepped down from her post, with immediate effect. Ms Fiorina said that she and the board had “differences about how to execute HP's strategy”. In 2002, Ms Fiorina pulled off a controversial merger between HP and Compaq, over strong opposition from some shareholders.

See article

Euronext, a European exchange operator, released details of its plan to buy the **London Stock Exchange**. Euronext said its potential merger with the LSE could create savings of *euro*203m ($260m). But unlike its German rival, Deutsche Börse (which released its own plan two weeks ago), Euronext did not put a price on the offer. Neither exchange has made a formal bid.

See article

A merger between two American banks, **Riggs National** and PNC **Financial**, collapsed and was then revived. PNC had agreed to buy scandal-hit Riggs for $779m last July, but wanted new terms when more trouble emerged in January. Riggs accepted a lower price, $654m.

See article

Jordan's **Arab Bank** is to close its operations in America, its home country's central bank announced. The bank faces investigations by American regulators and is being sued for allegedly facilitating the financing of terrorism. It denies any wrongdoing.

Advanced computing

IBM unveiled a new **computer chip** called “Cell” that will run about ten times faster than the chips found in the fastest desktop PCs today. The chip, developed in conjunction with Sony and Toshiba, is being widely hailed as a significant development in the evolution of computing technology and a challenge to Intel, the current market leader.

See article

Microsoft bought Sybari Software, a private company that specialises in anti-virus software for businesses, for an undisclosed amount. The acquisition is a response to the growing threat from computer viruses to Microsoft's operating systems. Eight security fixes that carry Microsoft's highest threat rating were released to users this week.

The world's largest maker of computer networking equipment, **Cisco**, said its net earnings in the three months ending January 29th were $1.4 billion, twice as much as in the same period a year earlier.

Vodafone appointed a new head of operations in Japan. William Morrow is being parachuted in to halt a sharp decline of Vodafone's Japanese mobile-phone subscribers (59,000 in January alone). The country accounts for 20% of the group's global revenues.

Va va voom

French carmaker **Renault** reported a 43% rise in net income in 2004, to *euro*3.6 billion ($4.6 billion). The jump in profit was driven by *euro*2.2 billion in earnings from Nissan, the company's Japanese affiliate, of which Renault owns 44%.

Toyota appointed Katsuaki Watanabe as its new president, succeeding Fujio Cho.

Mitsubishi Motors, a troubled Japanese car company, said its net loss for the nine months ending December 31st had more than doubled to ¥228.2 billion ($2.1 billion) compared with the same period a year earlier.

British Airways posted a 41% drop in net profit to £49m ($91m) for the three months ending December 31st compared with the same period in the previous year. The airline said its fuel costs had increased by 47%.

BP, the world's second-largest private-sector oil company, announced a 26% increase in net income in 2004, to $16.2 billion. The company said it might distribute $23 billion through share buybacks and dividends over the next two years.

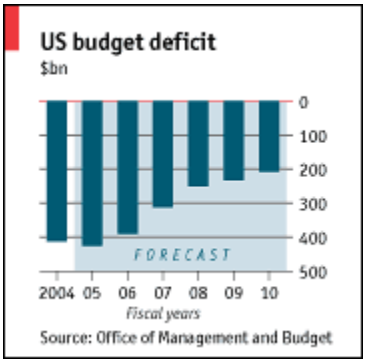
America's largest hotel group, **Marriott International**, said that fourth-quarter income from continuing operations, net of taxes, was $188m compared with $170m for the same period a year earlier. The company said that fears of terrorist attacks and recession had receded and forecast growth in revenue per available room of up to 9% in 2005 in North America.

The **dollar** reached a three-month high against the euro, helped by optimistic comments by Alan Greenspan, chairman of the Federal Reserve, on the possible stabilisation of America's current-account deficit.

How low will it go?

In America, the Bush administration released its **budget** proposals for the 2006 fiscal year, which starts in October. The administration estimates that the government's budget deficit will be 3.5% of GDP for the current fiscal year, and will then fall by more than half by fiscal 2008-09, though this depends on whether Congress is willing to reduce many of its favoured programmes, including Medicaid and, controversially, subsidies to farmers.

See article



Israel and the Palestinians

Together to the promised land

Feb 10th 2005
From The Economist print edition

This time, don't let go

AP

Get article background

THE Middle East has seen peace plans galore. They do not all fail. Israel now has peace treaties with both Egypt and Jordan. And yet the Israelis and the Palestinians have made only two efforts at direct peacemaking since Israel's founding in 1948. The first was the so-called Oslo process that followed the peace conference George Bush senior convened in 1991. Israel agreed gradually to transfer parts of the occupied West Bank and Gaza to Yasser Arafat's control, in the hope that this would build mutual confidence. The process limped along for most of the decade and then petered out. The second effort was Israel's headlong dash under Ehud Barak to force Mr Arafat to settle the entire conflict in one go, with Bill Clinton as referee, at Camp David in 2000. This, alas, did not peter out. It collapsed ignominiously amid high drama, dashing the hopes of the stateless Palestinians and so contributing to the eruption of the uprising, or *intifada*, that has killed more than 3,000 Palestinians and 1,000 Israelis over the past four years.

If the killing really stops, the truce declared this week from Sharm el-Sheikh by Ariel Sharon, Israel's prime minister, and Mahmoud Abbas (Abu Mazen), Mr Arafat's newly elected successor, means that the *intifada* is over and a third phase of peacemaking has begun (see article). But if they are to succeed, the peacemakers must learn the lessons of the previous failures. And the lessons of each point in opposite ways.

Oslo showed the perils of caution. Israel's gradual transfer of some towns and villages to Mr Arafat's control did not foster confidence. The Palestinian Authority he created was riddled with corruption and failed to stop all the terrorism of Palestinian rejectionist groups such as Hamas and Islamic Jihad. Meanwhile, Palestinians who watched the relentless expansion of Israeli settlements throughout the occupied territories stopped believing that Israel would ever leave them.

Camp David, in contrast, showed the perils of impetuosity. Not all the wiles of Mr Clinton nor all the weight of a superpower were able to close the gap on the wicked issues: how to share Jerusalem, where to draw the border and the fate of the Palestinian refugees of 1948. It is a dangerous thing to pump up the expectations of people who have experienced nearly 40 years of pent-up frustration under military occupation.

Sharon and Abbas can help each other

This time, the peacemakers will therefore have to steer a middle course between excessive caution and excessive haste. This rules out dealing immediately with the final-status issues of borders, Jerusalem and refugees. After the slaughter of the past four years, neither side is in a mood to make the compromises they could not make at Camp David. Palestinians want something tangible to show for their armed struggle. Israelis want to show that they do not buckle in the face of terrorism. Since these are incompatible aspirations, Mr Abbas and Mr Sharon will not be able to make progress unless each is willing to help the other give his people a part of what they want.

Will they try? And can they succeed? At least for the period until they start to talk again about a final peace deal, their interests coincide. Mr Sharon is a former super-hawk and territorial maximalist who has had some sort of epiphany. If he continues to outflank his enemies on Israel's right, who accuse him of betraying them, he is set fair to demolish the Palestinian perception that Israel talks and stalls but never quits a single settlement. Later this year Mr Sharon intends to evacuate all 7,000 or so Israeli settlers (and their protective soldiery) from the Gaza Strip and so end the occupation for more than 1m Palestinians. Before then, he could transform the atmosphere in the West Bank by removing the iron fist Israel clamped on Palestinian towns and villages at the height of the *intifada*'s suicide attacks in 2002.

The danger here is that Mr Sharon needs Palestinian violence to end if he is to relax the army's grip on the West Bank and push the Gaza withdrawal through his restive parliament. And although Mr Abbas at Sharm el-Sheikh promised an end to all attacks on Israelis, he gave this undertaking without the formal consent of Hamas and Islamic Jihad. If such groups resume their habit of plastering Israeli towns with makeshift rockets and sending suicide bombers to blow up Israeli buses and coffee shops, the peace opening will slam shut. On paper, as Israel rightly notes, the Palestinians are obliged under the international “road map” to dismantle terrorist organisations. But in practice, as Israel plainly knows, Mr Abbas is probably not able and certainly not willing to launch what might become a Palestinian civil war against groups whose exploits in the *intifada* have earned them a huge following.

Israel is entitled to expect more later. While Mr Abbas is still weak, its own interest lies in helping him to impose quiet by his preferred method of persuasion. The more the Palestinians come to believe that their lives are improving, and the occupation drawing to an end, the harder it will be for Hamas to return to violence. So it is splendid that Condoleezza Rice, America's new secretary of state, pledged new money for the territories on her visit this week. But planting a belief that the occupation is ending will require more than America's money and Israel's removal of roadblocks. Palestinians fear, with reason, that Mr Sharon may be leaving Gaza mainly to dig deeper in the West Bank. If they are to believe that President Bush is serious about a viable Palestinian state, he must also insist on Israel implementing its long-promised settlement freeze.

Once Israel has left Gaza and Mr Abbas has built a government capable of controlling the rejectionists it will be time to return to the question of borders, Jerusalem and refugees. Mr Bush will have to knock heads together harder than Mr Clinton did in 2000. Ending the conflict, desirable then, is now essential. For good or ill, Mr Bush has embarked on a mission to transform the Middle East. Contrary to common wisdom, Palestine is not the fount of that region's problems, most of which stem from a deeper failure of politics in Arab countries. But its support for Israel has become the Achilles' heel of America's relations not only with the Arabs but with the wider Islamic world. Quitting Gaza could be an excellent first step. But then Israel will have to leave most of the West Bank too.

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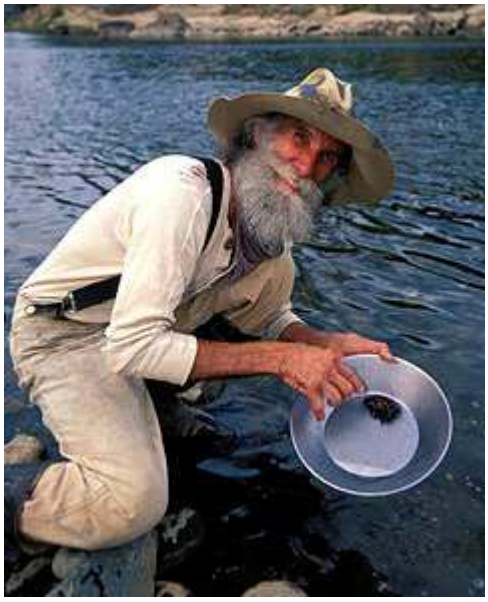
America's pensions

How to mend Social Security

Feb 10th 2005
From The Economist print edition

America does not have a pensions crisis; it has an opportunity that George Bush is half-grasping

Alamy



HE IS on the march again—this time, at home. In recent weeks, George Bush has tirelessly promoted his plan to reform America's biggest and most popular government programme, the Social Security pension system; and he has kept to that message, despite overwhelming opposition from Democrats and much naysaying from Republicans. Meanwhile, just when you might have expected him to continue his first-term habit of enticing politicians to his side with generous hand-outs, he is proposing a budget that is tough on spending.

These two problems—Social Security and the budget—are certainly linked, and both need addressing. Consider, first, the plans for Social Security. This is a giant of a challenge. The payroll taxes that finance the public pension system account for more than 25% of all federal revenue; its payments represent more than 20% of all federal spending. For almost two-thirds of America's pensioners, Social Security payments make up over half their income. And thanks to people living longer and having fewer children, its finances are in trouble.

Mr Bush says Social Security must be fixed now or else it will go bust—a good sales pitch, though the pension system is currently in surplus and will not even go into deficit till 2018 (never mind "go bust"). Indeed, Social Security looks sound compared with Medicare, the public health-care system for the elderly, whose long-term deficit is several times bigger.

Yet Mr Bush is right to start now. Better to get Social Security reform under way before the huge baby-boom generation starts to retire. The plan could be a model for dealing with Medicare. And giving people ownership of their savings, which the plan seeks to do, is a good thing in its own right.

Careful with the details

Even so, Mr Bush's charge forward should be greeted with two big caveats. The first is that in his focus on Social Security he must not lose sight of the overall fiscal challenge—and the role his own policies have played in it. The long-term burden of Mr Bush's first-term tax cuts and spending increases is three times bigger than the looming Social Security shortfall. Pension reform is

desirable; but it will not solve America's long-term fiscal problems, and if its political price is an out-of-control budget, that would be a serious mistake.

The second caveat is that Mr Bush must get the details of the reform right. Many are unresolved, but the basics are in place. He has ruled out raising payroll taxes or tampering with the benefits of anybody aged 55 or older—a political necessity. The plan's main idea is to let people divert up to a third of their payroll taxes into individual retirement accounts. In exchange, the account-holders would get smaller pensions from Social Security. The government would see its revenues fall in the short term, but its future liabilities would be lower as well.

Mr Bush has insisted that the new accounts must come about only as part of an overall plan to close the financing gap. From the retirees' point of view, the “carve-out” that diverts money from Social Security to the private accounts, so hated by Democrats, is a good idea. It will lessen dependence on government and may encourage people to save more. There is no reason to believe the horror stories that Wall Street is about to fleece helpless savers: learning from other privatisations overseas, Mr Bush's people want the new retirement accounts to be managed in a way that will keep costs low.

But, from the point of view of economic policy, the carve-out also has its limits. By itself, it will not close Social Security's long-term financing gap, because it reduces the amount of money going into the pension system as well as the amount coming out. Mr Bush has been unclear about how he would close this gap without raising the payroll tax; the White House has talked about moving from a system in which initial benefits are linked to wages to one where they are linked to prices, which generally rise less than earnings. Separately, the carve-out will worsen the short-term fiscal imbalance: the up-front transition costs will add $754 billion to government borrowing over the next ten years. And it will do nothing to raise America's low savings rate, because the increase in private saving will be offset by higher public borrowing.

Recruit some Democrats

A good idea would be to combine the carve-out with additional contributions, or “add-ons”, as some Democrats advocate. Mr Bush should find a compromise whereby individuals could divert some share of payroll taxes into their retirement accounts in return for paying higher overall contributions. If these add-ons are to be voluntary, a subsidy might be needed to encourage poor people to take part. There would still be transition costs, but these arrangements would make a rise in national saving far more likely.

Other changes are needed too, and should be politically possible for a president who says that everything is on the table. It would be a mistake to rely on indexing pensions solely to prices: this would hurt many poor pensioners and arouse an eventual backlash (as in Britain). Some form of “progressive indexing”, where initial benefits are indexed to a mixture of prices and wages, varying according to income, is more equitable and politically more sustainable. Mr Bush can pay for this by hoisting the retirement age, and by raising the cap on the payroll tax, currently set at $90,000; that obliges poorer Americans to pay proportionately higher payroll taxes than richer ones. Partial add-on accounts plus a financing strategy that does not rely exclusively on lower benefits might attract enough Democrats to pass.

Note that changes such as these—delaying the retirement age, raising the payroll cap, and so on—are the ones that will actually stop Social Security going bust. In that regard, Mr Bush's new retirement accounts are no help. Yet this misses the point. Giving people greater control of their savings is desirable in itself: that is why private accounts deserve their place in this reform. It is wrong that in the world's most advanced economy so many retirees should rely so heavily on the state. That idea is at the heart of Mr Bush's “ownership society”—and it is worth supporting.

The drug “war” in Latin America

Next steps in Colombia

Feb 10th 2005
From The Economist print edition

More aid is needed because of the failure of drug prohibition

Reuters

WORRIED that Latin America's third most-populous country was becoming a failed state overwhelmed by drugs and guerrillas, in 2000 Bill Clinton launched an ambitious programme of mainly military aid called Plan Colombia. The plan, which has enjoyed broad bipartisan backing in the United States Congress, is due to lapse in September. Nevertheless, in his budget released this week, George Bush proposes to keep aid to Colombia largely unchanged in 2005-06, at some $742m. Before this becomes a permanent commitment, Americans and Colombians should look carefully at its value.

Though sold to Americans as a decisive move in the “war” on drugs, the core of Plan Colombia is counter-insurgency. In this, it can claim much success. American aid has given Colombia's army a large helicopter fleet and better intelligence. Mr Bush allowed the aid to be deployed not just against drugs but against Colombia's illegal armies, the left-wing FARC and the ELN and the right-wing paramilitaries of the United Self-Defence Forces of Colombia (AUC). Colombia has done its bit too: the army is bigger and more professional, though, worryingly, some officers continue to collude with the AUC.

Five years on, the FARC is on the defensive—though far from beaten. The government's writ runs over some previously lawless areas of a vast country. Killings and kidnappings are down, though last year violence still drove at least 140,000 people from their homes. Peace talks with the AUC have seen some 2,600 (out of 20,000 or so) of its troops demobilised.

On drugs, too, Plan Colombia claims victories. Álvaro Uribe, Colombia's president, has championed aerial spraying of coca fields with weedkiller. Since 2000, land under coca has almost halved. Yet as always in the war on drugs, victories are illusory (see article). Cocaine is as cheap as ever. Drug prohibition in rich countries continues to fail—at huge cost for Latin America's democracies, whose battle to enforce the rule of law is contested by powerful drug mobs. In five years, Plan Colombia has offered no evidence to weaken *The Economist*'s conviction that cocaine should be legalised (though its use, like that of tobacco, should be discouraged).

Rationing carrot and stick

As long as prohibition continues, Latin American governments have to try to contain the drug trade's ill-effects. So Colombia's democracy has a right to expect aid from countries whose cocaine habit helps finance its insurgents. But not at any price. Bringing peace to Colombia requires a

careful balance of carrot and stick. Mr Uribe's predecessor offered the FARC many carrots—in vain. Now Mr Uribe risks a similar error with the AUC. This outfit, let it be remembered, commits many of the worst atrocities of Colombia's conflict, and is more deeply involved in drugs than the FARC. But the president is blocking a bill in Colombia's Congress which would require the AUC to forfeit illegally acquired assets, confess crimes and dismantle its organisations. This bill would apply the same test to any future guerrilla demobilisation.

Last week aid donors, mainly from Europe but including the United States, refused to provide money the government needs to finance the AUC's demobilisation unless the bill is passed. They were right to do so. But, conversely, Europeans must accept the logic of their own scruples: if Colombia is to bludgeon its rebels to submit to the rule of law on tougher terms it will need much more military aid.

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Aid, debt and development

Show us the money

Feb 10th 2005
From The Economist print edition

AFP

Credible policies and hard cash, not accounting trickery, are needed in the fight against poverty

IF SAYING the right thing were all that mattered, this year of "making poverty history" could already be declared a triumph. The corporate bosses, political leaders and assorted celebrity do-gooders gathered last month in Davos talked of little else but their ideas to help the poor. Yet what really matters is not words but action. This year, policymakers will have opportunities a-plenty to do the right things at several high-level meetings—the G8 summit in July, a special assembly of the United Nations in September to discuss progress towards the Millennium Development Goals (which include halving the proportion of the world's population in extreme poverty by 2015) and the World Trade Organisation gathering in December.

For an early clue to whether these meetings will deliver the goods, all eyes were on last weekend's gathering of the G7 finance ministers (see article). An upbeat communiqué was duly issued, pledging more aid, more debt relief for poor countries and freer trade. Yet behind the headline pledges was a tangle of disagreements over how much more aid and debt relief to provide, how to pay for it and how to deliver it. True, the meeting was primarily intended to set a bold agenda, which it did. Even so, these disagreements will not be easily resolved.

Consider, for instance, the promise in the communiqué to provide "as much as 100% relief" on the debts of the world's poorest countries to the IMF, the World Bank and other multilateral lenders. The words "as much as" cover a multitude of views on debt relief, from those such as Britain's and America's—keen on 100% relief in the right circumstances—to that of Japan, which questions the usefulness of any debt relief.

On balance, it is to be hoped that Japan will come to agree with Britain and America on this issue,

as debt relief, when it works well, can be the best form of financial assistance. It puts more money in the hands of the recipient country, so it can take charge of its own development. Yet for that very reason, debt relief can also be a perversely efficient way of rewarding the worst sorts of poor-country governments, which may use their improved cash flow only to develop the president's Swiss bank account. Thus, debt relief should be given only when the government receiving it is likely to put it to good use. That has been the aim of the heavily-indebted poor country (HIPC) initiative, which may now be extended—though HIPC relief has a mixed record in practice, in part because the need for donors to be tough has often been trumped by their wish to appear generous.

When a government cannot be relied upon to use debt relief well, aid focused on specific goals is a better use of foreign money. Britain's promise to buy vaccines against HIV/AIDS and malaria for distribution in poor countries, which it hopes will provide the financial carrot necessary to get drug firms to develop them, is a potentially excellent use of an aid budget.

Arguably the most worrying dispute among rich countries is over how to pay for the war on poverty. As well as the familiar techniques of unfunded pledges and redirecting existing aid flows, gimmicks have been proposed, such as a “Tobin tax” on international financial transactions (unworkable) and a tax on aviation fuel or air tickets (which could work, and can be justified on environmental grounds, but has no link to poverty). More ominously, some G7 finance ministers seem tempted by various “off-balance-sheet” financing schemes, the sort of trickery notoriously associated with Enron. The IMF, say, might pay for the cancellation of debts by revaluing or selling its gold reserves—this could conveniently avoid counting the cancelled debt as public spending.

A tsunami lesson

Another off-balance-sheet manoeuvre is the International Financing Facility (IFF) championed by Gordon Brown, Britain's chancellor of the exchequer. This would let governments borrow against their own future aid budgets without counting such borrowing in their public accounts. The IFF's borrowing would be treated as only a contingent liability of the governments concerned (a technicality that should make IFF debt more expensive than straightforward government debt).

Is such trickery ever desirable, even to help the poor? And is it even necessary? Surely the public response in rich countries after the Asian tsunami demonstrated that, when people believe their money will be well spent on relieving misery, they are ready to be extremely generous. This year, politicians should instead use their creativity to come up with credible policies for reducing poverty confident that, if they do so, their voters will not need to be deceived into paying the bill.

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Corporate profits

Breaking records

Feb 10th 2005
From The Economist print edition

Capitalists are grabbing a rising share of national income at the expense of workers

WOODY ALLEN once quipped "If my films don't show a profit, I know I'm doing something right." For most other people, in most other circumstances, profit is a mark of success, and in most countries corporate profits are currently booming. Last year, America's after-tax profits rose to their highest as a proportion of GDP for 75 years; the shares of profit in the euro area and Japan are also close to their highest for at least 25 years. UBS, a Swiss bank, estimates that in the G7 economies as a whole, the share of profits in national income has never been higher. The flip side is that labour's share of the cake has never been lower. So are current profit margins (and hence equity values) sustainable? Are they fair?

Corporate profits may be inflated in various ways. If firms made full provision for the future cost of pensions, their earnings would be smaller. And especially in America, the share of profits in national income has been bolstered by the surging profits of the financial sector which have benefited hugely from falling interest rates. Even so, the impressive efforts of American firms to boost productivity and cut costs are genuine (see article). Firms elsewhere, notably in Japan and Germany, are also restructuring aggressively. The share of profit in GDP always rises sharply after a downturn, but in the United States a bigger slice of the increase in national income this time has gone to profits than in any previous post-war recovery. Over the past three years American corporate profits have risen by 60%, wage income by only 10%.

If the share of wages in GDP continues to slide, there could be a backlash from workers who feel short-changed. Yet the chances of this are lower than before. The old divide between "them" and "us" is becoming blurred: many workers also own shares directly or through pension funds, which sooner or later will give them a slice of profits. In any case, there are good reasons to believe that profits growth will soon slow sharply and that workers will make up some of their lost ground.

An economic fallacy

The usual explanation for why profits are booming is that productivity growth has increased thanks to the computer revolution and tougher management. Thus, goes the argument, increased productivity and hence lower production costs mean fatter profit margins. History suggests otherwise. It is normal for the share of profits in national income to rise during the early stages of a technological revolution, but then those extra profits tend to be competed away. Higher profits tempt firms to cut prices to steal market share; they also increase the incentive for new firms to enter the market. The benefits of the productivity gains from railways, electricity or the car eventually went not to producers but to consumers and workers, as competition forced firms to

pass cost savings on as lower prices and higher real wages. There is even greater reason for thinking that the benefits of computing technology will flow the same way, for it also increases competition in many industries by lowering barriers to entry and making it easier for consumers to compare prices on the internet.

However, there is another factor that might have raised the return on capital relative to labour in a lasting way, namely the integration of China and India into the world economy, along with their vast supply of cheap labour. To the extent that this increases the global ratio of labour to capital, it will lift the relative return to capital. Outsourcing may not have destroyed many jobs in developed economies, but the threat that firms could produce offshore helps to keep a lid on wages. As a result, the share of profits in national income could stay relatively high for a period. Labour's share would remain low, though workers may still be better off if the cake itself is growing faster. But this is not a reason to expect profits to continue to grow faster than GDP; indeed, in a competitive market profit margins will eventually narrow. Even if outsourcing reduces costs, competition will eventually force firms to reduce prices, distributing the benefits back to consumers and workers.

Stockmarket investors seem to think otherwise: current share valuations appear to assume that profits will continue to outpace GDP growth. Most analysts still expect American profits to grow by an annual 10% over the next couple of years. With nominal GDP growth of around 5%, that implies the proportion of GDP going to profits growing still larger. But this looks unlikely, and if so, share prices are overvalued. Both economic theory and historical experience argue that, in the long run, profits grow at the same pace as GDP. Such long-standing rules deserve more respect.

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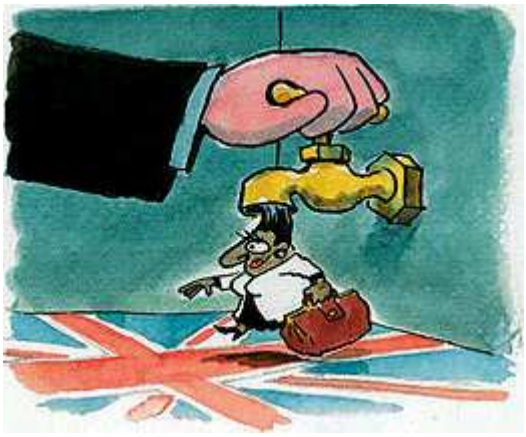
Immigration in Britain

After the flood

Feb 10th 2005
From The Economist print edition

Why the British government's new plan for controlling immigration is a bad idea



DEBATE about immigration is steeped in metaphor, ranging from Enoch Powell's rivers of blood to the more usual waves of foreigners flooding the nation and swamping public services. The imagery is usually liquid, carrying with it the idea of a force of nature, rushing out of governments' control.

That notion suits the Conservatives nicely. Michael Howard, the Tory leader, wants immigration to be one of the big subjects for the election expected in May. That's not surprising: it is the only important policy area in which voters consistently give the Tories higher marks than the government. The government is equally keen to dispel the idea, which is why this week it announced plans to restrict entry further.

Good migrants and bad migrants

The government's determination to show that it has got things under control is understandable, but is based on two mistakes. The first is the idea that immigration is out of control. Three years ago it was, partly because the bureaucracy was in a mess and partly because conflicts in various troubled places (a factor sadly way beyond the government's control) led millions of people to flee their homes. The number of asylum-seekers trying to get into Britain peaked in 2002 at 8,700 a month. Since then, the government has done much to make the system work better, and applications have fallen by 60%. However, the number of people being granted work permits has gone on rising and now stands at more than twice the number of asylum-seekers. But the government itself sets the number of work permits, so the high current inflow of foreigners is not a sign that immigration is out of control.

Voters seem to understand this. Polling shows that Britons tend to dislike asylum-seekers but are untroubled by foreigners who have come to work. That may say uncomplimentary things about both the compassion of the British people (asylum-seekers' economic inactivity is hardly their own fault, since they aren't allowed to work) or their logic (“bogus” asylum-seekers, the most-hated category, are, after all, economic migrants by another name) but it also suggests that the issue may lose its political salience. The polls support that idea: concern about immigration peaked with asylum applications in 2002, and has since fallen alongside them. So the government's worry that the Tories have put their finger on a hot electoral button may be misplaced.

The second mistake lies in the direction of policy. Over the past five years, the government has quietly liberalised the work-permit system: businesses, which used to have a tough time getting permits for foreigners, now find that applications go through pretty much on the nod. By and large, it is employers who determine what kind of immigrants get jobs. They ask for permits, and the government responds, usually positively.

But if the government wants to be seen to be getting things under control, it cannot just let employers decide who gets into the country. That's why it is now moving away from a system that responds to employer demand to one driven by what the government thinks the economy needs. Under the new rules, fewer low-skilled workers will be allowed in, while those with plenty of qualifications and experience will be welcomed, particularly if their skills fall into categories believed to be in short supply. A committee of experts will be assembled to determine exactly what those skills are.

This way of managing immigration has a respectable pedigree—sensible people such as the Australians and Canadians do it—but that does not mean it makes economic sense. Employers are better than governments at knowing what jobs are in short supply (as Australian employers discovered a while ago when the government got its sums wrong and left them with a critical shortage of doctors). If governments think that immigration is running at politically unacceptable levels, they should limit total numbers. Micro-managing the labour market is not the answer.

Until now, the government has been quietly and commendably liberal on economic migration, but now it is worried. It hasn't yet started building dykes, but is trying to channel the flow. That is a mistake: it risks ending up with a flood in one place, a drought in another and a policy up the spout.

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Letters

Feb 10th 2005
From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Commitment to Iraq

SIR – It is doubtful that the most fervent opponents of American policy will be satisfied, even if the Iraqi elections turn out to be a resounding success ("Democracy at gunpoint", January 29th). By attempting to promote democracy, the Bush administration has at least recognised the fundamental dignity of the Iraqi people (the many deaths in the conflict notwithstanding). And if the elections nurture a modicum of decent government for Iraq then it will be nothing less than historical.

The insurgents have nothing to gain from further balloting, but much to lose. All the same, coalition forces have not fully pacified the more troubled parts of the country. A continued American presence in Iraq is thus necessary to ensure a semblance of security. To quit the country at this time would be patently irresponsible. Such a departure would damage American prestige not just in the Middle East, but possibly everywhere.

Charles Rieper
Columbus, Ohio

SIR – As an Iraqi who has been living in the West for 20 years, I think I can say that the larger issue for Iraqis at the moment is just when will the Americans be ready to leave? If there was a firm schedule to depart, replacing khaki helmets with blue berets under UN control, things would immediately change. It is quite conceivable that all Iraqis, regardless of their race or religion, would agree on such a solution and I would not be surprised if the insurgents then dropped their weapons.

Weshah Razzak
Wellington, New Zealand

SIR – America should prove to the Iraqi people that they do not live in an occupied colony. Let them vote in a referendum on whether the US military should stay. If the people decide that troops should leave, then George Bush should order them home.

PAUL FEINER
Greenburgh, New York

Clash of symbols

SIR – I strongly disagree that a ban in Europe on Nazi symbols risks redefining what happened 60

years ago as a European, rather than a German, tragedy (Charlemagne, January 22nd). Germans alone are blamed for the Holocaust, yet we forget that the scope of the atrocities was made possible because of tacit support by large portions of occupied populations all over Europe, from France and the Netherlands, to Lithuania and the Ukraine. Germany did not have the manpower by itself to carry out killing on such a massive scale. The logic of a blame game is dangerous and enables us to forget how easy it is to descend to the depths of inhumanity that we have seen throughout history.

Burkhard Maier
Wyomissing, Pennsylvania

SIR – The crucial point on displaying Mussolini's photo in the Palazzo Chigi is whether a photographic collection on public display is intended as a purely historical record of who held public office and when. Omitting people from the record would be as much a disservice to the truth as was the Soviet practice of airbrushing people out of photos.

Martin Weston
Strasbourg, France

SIR – In closing your soft rebuke of Prince Harry for his fancy-dress blunder, you state that “a similar action by a prominent young German would have been a lot more sinister and disturbing”. Considering that Windsor is just a stage name, appropriated by King George V during the first world war, doesn't Harry von Saxe-Coburg-Gotha qualify as a prominent young German?

Martin Fleischmann
Venice, California

Free speech on campus

SIR – You were wrong to upbraid Harvard president Larry Summers for his comments on the possibility of innate differences between men and women (“Birdbrained”, January 22nd). Mr Summers merely suggested further research in the field in the face of academic conformity, so prevalent on campuses today. Unsurprisingly, Mr Summers has not only apologised vociferously for his outburst of non-conformist thought, but has set up a task-force to investigate the obstacles that women face at Harvard. Principles of academic free speech should apply at all levels of the university. If not, the next intelligent individual capable of thinking outside the box (even if provocatively) will surely reconsider before returning to the academy.

Simon Rabinovitch
Cambridge, Massachusetts

My generation

SIR – I appreciate Paul McGuinness taking the time to send in his music-conglomerate boilerplate in favour of the extension of copyright (Letters, January 29th). Does he truly believe the world would be a finer place if the heirs of Mozart needed to be contacted for approval and fee negotiation before each symphonic performance?

Philip Gross
New York

The good company

SIR– You say in your survey of CSR that “private enterprise requires a supporting infrastructure of laws and permissions, and more generally the consent of electorates, to pursue its business goals” (January 22nd). Do you imply that private enterprise should stay out of states where an infrastructure of laws and permissions is lacking and where political structures are autocratic so that there is no electorate worth its name? It is not the advanced democracies in the developed world, but the failing states with autocratic regimes in the developing world, that the concept of CSR has to address.

Otto Keck
Potsdam, Germany

SIR – You neglected to mention some important business aspects to CSR. Such aspects include: exploiting new revenue opportunities that emerge from environmental worries (hence car companies creating a hybrid niche); being at the table as accounting standards for social and environmental bottom lines are hammered out (witness the Global Reporting Initiative); winning access to developing markets by bringing along first-world HR practices; and acknowledging that NGOs have effectively become a new class of regulators to be ignored at shareholders' financial peril. None of these depend on the apparently contentious possibility that corporations are comprised of socially responsible human beings who are unlikely to deliver their most productive efforts if indicted as “ not competent” to concern themselves with the public good.

Niel Golightly
Ford Motor Company
Dearborn, Michigan

Go north, young man

SIR – American students who want to escape the apparent prohibitionist stranglehold in their universities do not need to study all the way across the Atlantic (“Booze control”, January 22nd). They could simply come to Montreal, where the drinking age is 18.

Jesse Guy-Herman
Montreal

SIR – Students need to drink. If anyone can successfully make it to their mid-20s without the soothing charm of alcohol there is, quite frankly, something wrong with them. University is a notoriously stressful place. This is especially true in America, where, I hear, they actually make you do some work.

Paul Davies
Winchester, Hampshire

ONLINE ARTICLES

The following correspondence refers to articles published only online

France and America

SIR - French foreign minister Michael Barnier commented that "Alliance does not mean allegiance" ("Let's be friends", Economist.com, February 9th). He should have used the word *loyaute*, which could either mean allegiance or loyalty. No matter what overtures the French make, they have been and will continue to be fair-weather friends. I am unconvinced by those who would disdainfully deal with America because the "belligerent Texan" got another four years.

Those of us from the "blue states" know all too well that sometimes the president's views do not reflect our own, but the French slights of the past four years affected even those of us who may have agreed with them either in part or in principle. To sum up, thanks but no thanks to the French.

Nathaniel Wang
Redlands, California

The Volcker report

SIR - Your article on the Volcker report ("Volcker's awkward questions", Economist.com, February 4th) leads one to consider the United Nations in a wider context: it is not a perfect organisation, and not only due to its own faults. The UN is always under the self-interested influence of major powers; countries should sort out their meddling in the UN in pursuit of their own interests, before criticising the world body for shoddy work in general.

Ambrose Tan
Singapore

Retort

SIR - You say that George Bush has placed tort reform at the centre of his second-term legislative programme ("The war on tort", Economist.com, January 26th). Ranged against him are the massed ranks of America's trial lawyers. You asked, who will come out on top? If Mr Bush and tort reformers succeed in duping legislators, the more pertinent question is who will come out on the bottom? The answer, of course, is victims of medical malpractice.

You say that according to figures from Tillinghast-Towers Perrin, an insurance consultancy, tort-system costs amounted to $246 billion in 2003. The firm has finally admitted that its report has nothing to do with the costs of litigation, courts or the legal system but is based on figures generated from the wasteful and inefficient insurance industry, even going so far as to include its administrative costs.

Not only has this report been debunked but in state after state the myth that a cap on non-economic damages will assure that medical malpractice insurance premiums will be lowered has been debunked as well. Medical malpractice creates victims. Then tort reformers seek to make them victims once more by denying them a basic constitutional right: that a jury decides what recompense for their injury is appropriate.

Jane Marshall
Clarksville, Tennessee

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The north Caucasus

An empire's fraying edge

Feb 10th 2005 | BESLAN, NALCHIK, NAZRAN AND VLADIKAVKAZ
From The Economist print edition

Corbis

The creeping destabilisation of the north Caucasus, and what it means for the future of Russia

Get article background

IN ANY other European country, the carnage would have caused horror. But ten years of war in Chechnya have inured most Russians to the fates of desperadoes such as the obscure Islamist group that two weeks ago holed up in an apartment in Nalchik, the capital of the north Caucasian republic of Kabardino-Balkaria. A three-day siege ended bloodily: the apartment was gutted, and its seven occupants, alleged perpetrators of a murderous attack on a government agency in December, were all killed.

Still, the location of this particular last stand was troubling. Kabardino-Balkaria had until recently been a patch of relative calm in Russia's poorest, angriest and most complex region. So too, until last October, had seemed Karachayevo-Cherkessia, Kabardino-Balkaria's western neighbour. Then seven businessmen were killed, and their bodies thrown down a mine. The son-in-law of the republic's president was implicated in the murders, and a mob stormed the presidential headquarters in Cherkessk, the capital. A putsch was averted, or perhaps postponed. Last September, the siege in Beslan, North Ossetia, was horrific enough—over 330 hostages dead, more than half of them children—to appal even the most hardened of Russians.

Not so long ago, observers worried that the conflict in Chechnya would spill across its borders. Now the question is not whether it will spread, but where the spreading will end. “The explosive potential of Chechnya,” says Enver Kisriev, a Dagestani academic, “is being dispersed through the north Caucasus.” Even by Russian standards, the beautiful but benighted region's difficulties are

extreme. But they are extreme versions of problems that afflict the country as a whole: poverty, fissiparousness and poor governance. And the explosive tendency of the north Caucasus may ultimately threaten the integrity of that whole.

After Chechnya, the north Caucasian republic with the most unstable recent history is Dagestan, the largest (see map). Religious extremism, violent criminal groups and a dizzyingly fragmented ethnic rivalry are all entrenched. A raid into Dagestan by Chechen fighters in 1999 helped to ignite the second Chechen war (the first was fought between 1994 and 1996). Last month Ramzan Kadyrov—Chechnya's first deputy prime minister, and warlord son of a brutal pro-Moscow Chechen president assassinated last year—made another provocative violent incursion with some of his so-called *kadyrovtsy* henchmen after his sister was detained by Dagestani police. Assassinations, and shoot-outs between police and insurgents, are frequent.

But it is Ingushetia, Chechnya's small western neighbour, that has been most affected by spreading violence. Last June a phalanx of insurgents took over Nazran, Ingushetia's ramshackle main city, killing more than 90 people before retreating. On January 8th this year, a house on the edge of Nazran was razed in a siege.

According to Memorial, a human-rights watchdog, the security services' behaviour creates rather than staunches the trouble. As in Chechnya, masked men turn up in vehicles with no number plates. Sometimes the people they abduct are released; sometimes they are ransomed; sometimes they disappear; sometimes their bodies are found. Ruslan Zhadayev, who runs an information centre in a dilapidated Nazran apartment, relates how on January 12th masked and armed men forced his male colleagues to lie on the floor, lined the women against a wall, cut the phone line and removed the computers. They said they were hunting for terrorists; more probably, they meant to intimidate. But while many detect the hand of the FSB (Russia's post-KGB spy service) behind the mayhem, nobody seems really to be in control, including in control of the local FSB agents.

Ingushetia is not—yet—as perilous as Chechnya, where federal troops, the *kadyrovtsy* and plain criminals kidnap at will. Makhmut Magomadov, a human-rights lawyer, was abducted last month. The authorities mendaciously claimed that he has been released, a tactic that helps them disavow responsibility. Several relatives of Aslan Maskhadov, erstwhile president of Chechnya turned rebel, have also been seized. Memorial, which monitors only around a quarter of Chechen territory, counted 396 kidnappings last year: 24 victims have been found dead, and 173 have vanished.

The terror helps to explain why a sizeable rump of the Chechens who sought sanctuary from the war in Ingushetia are still there. Some are afraid to return because they have children of an age vulnerable to kidnap. One 55-year-old, who lost her three sons and her mother in the first war, says she has nothing to go back to: the house she left behind is now a pit. Her new home is a small cardboard-walled container in a Nazran yard. The only decoration is a poster of Alu Alkhanov, who took over as president of Chechnya from the slain elder Kadyrov after a sham election last year. She put it up, she says, because he gave her 1,000 roubles ($36) to vote. Looking for help, “I go round and round like a squirrel in a wheel.”

But the number of Chechen refugees in Ingushetia has fallen, from a peak of 240,000 to around 34,500 (many more are displaced within Chechnya itself). Murat Zyazikov, the president of

Ingushetia, says the returns have always been voluntary; some relief agencies report government pressure. Growing local hostility towards the Chechens has played a part. But so has the fact that, at least in the bald terms of the body count, the situation inside Chechnya is improving. Even if some of the war compensation money from the federal government is still stolen, more seems to be getting through. Mr Maskhadov and Shamil Basayev, Russia's most wanted man, last week reportedly declared a temporary “ceasefire”, though Mr Basayev has also vowed further abominations.

Who is to blame?

The slim improvements in grim Chechnya may help to explain some of the deterioration in the neighbouring republics. Some dislodged Chechen fighters have moved on. Cynics speculate that declining returns at Chechen border posts, and from smuggling and embezzlement, may also have something to do with it. But the region's problems have two other profound causes: its messy history, and a chronic failure of government.

Devilishly complex ethnic divisions, within and between republics; ancient but persistent grudges; a Babel of languages; clan-based sub-rivalries; war with Russia, from the tsars to Vladimir Putin, Russia's current president: such is the historical inheritance of the north Caucasus. Perhaps the most influential tragedy occurred during the second world war. A teacher in Zilgi, a predominantly Muslim village outside Beslan, says that, after the school siege, when her pupils ask her the eternal Russian question—who is to blame?—she gives a one-word answer: Stalin.

During the war, Stalin ordered the wholesale deportation of four north Caucasian Muslim nations, along with several others, at an enormous cost in lives: the Chechens and Ingush (ethnic cousins), Karachays, Balkars and Meskhetian Turks. A sliver of Ingush territory was given to North Ossetia—the only predominantly Christian republic in the region, and Moscow's traditional bulwark. (Vladikavkaz, the name of the North Ossetian capital, means “Power over the Caucasus”.) The Ingush tried unsuccessfully to recover the land in a short but nasty war in 1992. The husks of Ingush and Ossetian homes destroyed in the fighting still lie unrepaired. Thousands of Ingush refugees still live near the border, in scarcely better conditions than the Chechen exiles.

To live with this legacy—and to make the most of the powers conferred on Russia's autonomous republics by the Soviets, which they kept when the Soviet Union collapsed—the region needs strong, independent leaders. Instead it has communist relics, and ruling clans that monopolise local industry. As in the rest of Russia, business and politics are corrosively intertwined, and corruption is rampant.

A clutch of trouble

North Caucasian republics

Republic	Population	President
Dagestan	2.6m	Magomedali Magomedov*
Chechnya	1.1m	Alu Alkhanov† and Aslan Maskhadov‡
Ingushetia	470,000	Murat Zyazikov
North Ossetia	710,000	Alexander Dzasokhov
Kabardino-Balkaria	900,000	Valery Kokov
Karachayevo-Cherkessia	440,000	Mustafa Batdyev

*Unelected †Official ‡Separatist

Source: Goskomstat; Memorial; *The Economist*

The tribulations of the owner of a small taxi business in Vladikavkaz are instructive. He no longer needs to pay protection money to criminal gangs, but instead faces regular extortion by local organised-crime police. He covertly tapes the conversation when they visit; but the only real defence, he says, is powerful friends. You must be careful too, he says, not to be too successful. He himself would rather sell up than pay up, but “a lot of other people are frightened like a rabbit in front of a snake.”

Alexander Bazoev, boss of a big Vladikavkaz construction firm, says that, because “nobody knows what will happen tomorrow”, big companies are scared to invest; young people are moving away and the labour pool is drying up. All of which means that a region that ought to live comfortably

on transit trade and tourism is instead Russia's poorest. Mr Zyazikov, the president of Ingushetia, claims to have created some jobs. But unemployment in Ingushetia, as in Chechnya, is catastrophically high—perhaps 80%. In North Ossetia, where vodka production, much of it in the shadows, is the main trade, the situation is scarcely better. Kabardino-Balkaria is in the same state.

Local rulers with too much power of the wrong kind and too little of the right kind make for brittle government, unable to cope with shocks. Such as Beslan.

Five months after the siege, the school has been neither demolished nor preserved. Snow falls through the rafters to smother the scattered paraphernalia of lessons, and the toys and bottles of water (because the hostages were denied it) left by relatives of the murdered children.

The graffiti maps out the vectors of anger in the town. “We will ask our rulers first, and then the Ingush,” reads one scrawl. The renewed strife between Ossetians and Ingush, which, because there were some Ingush among the hostage-takers, was widely expected to ignite after the formal 40-day mourning period, failed to materialise. Opinion divides over whether it may yet. The Ingush living in North Ossetia, who paint the gates of their houses green, are easy to find.

But fury with the government has remained. The bereaved blame the authorities for failing to negotiate; for the botched storming; and for the pace of the parliamentary inquiry into the tragedy. Vladimir Khodov, a local administrative chief whose ten-year-old grandson was shot, says people are convinced that there were more terrorists than the authorities acknowledge, and that weapons were hidden in the school in advance. Parents say the federal compensation for a lost child—100,000 roubles—is insultingly low.

Some are angry with Mr Putin personally; others exonerate “Vladimir Vladimirovich”. But almost everybody wants Alexander Dzasokhov, the president of North Ossetia, to resign. They are still furious with the falsehoods Mr Dzasokhov's officials circulated during the crisis. Lev Dzugaev, the spokesman who disseminated implausibly low hostage figures (and now the republic's minister of culture), says the administration wanted to prevent a wider conflagration.

For many, the biggest scandal is that nothing appears to have changed to prevent another attack. A foreigner can still cross the North Ossetia-Ingushetia border without showing his documents. If the worst happens again, the response will be less patient.

What is to be done?

Like a sick child in a family, says Mr Bazoev, the Vladikavkaz businessman, the north Caucasus needs special attention. After Beslan, it is finally getting a little. Mr Putin dispatched Dmitry Kozak, one of his most trusted aides (and tipped to be prime minister if the current one is sacked), to be his representative in the region, with a special brief to foster economic development. Mr Kozak has talked candidly about the grip of clannishness and corruption. But he is spending much of his time quelling local revolts.

The state of the north Caucasus almost makes another post-Beslan reform—Mr Putin's assumption of the right to appoint regional governors—look like a good idea. Nostalgia for Soviet stability is more prevalent than longing for democracy. In Beslan, Mr Khodov talks wistfully about weekends spent driving through Chechnya and Dagestan to eat caviar by the Caspian. Unfortunately, the Kremlin tends to pick leaders for loyalty rather than competence. Ruslan Aushev, a respected Ingush president who negotiated with the Beslan terrorists, was eased out in 2001. The first regional test may come in Kabardino-Balkaria, whose president, Valery Kokov, is ill. In Vladikavkaz, Alikhan Khugayev, editor of an opposition newspaper, says that if Mr Putin appoints a

stooge in North Ossetia, “North Ossetia will explode.”

What sort of explosion? Active secessionist sentiment is weak. As Alexei Malashenko of the Carnegie Moscow Centre puts it, “Nobody is ready to pay the Chechen price for independence.” Local elites know going it alone is impractical. Since (as elsewhere in Russia) poor government and tax evasion go hand in hand, local administrations are cripplingly dependent on subsidies from Moscow.

Reuters

At Russia's Ground Zero

Likewise, the danger of violent Islamic radicalism is real, but limited. In Ingushetia and North Ossetia, people whisper about unknown bearded men turning up at mosques. Mass unemployment helps to make militancy seem like a good career option. But while the threat may be growing, only a small minority dream of a north Caucasian caliphate. Many of the region's problems have nothing to do with either religion or ethnicity.

The big risk is simply that more and more of the north Caucasus may slip into lawlessness and drift out of Moscow's orbit. After his meddling in Ukraine, pundits talked of Mr Putin's plans to reconstitute the Russian empire. But, in a sense, Russia is already its own empire. The possibility that it may one day crumble as the Soviet Union did is Mr Putin's central fear. The neglect of the north Caucasus may eventually lead to that fear's realisation.

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The south Caucasus

Murky

Feb 10th 2005 | TBILISI
From The Economist print edition

Trouble across the border, and for Georgia's boisterous president

Get article background

GIVEN his own problems in the north Caucasus, you might expect Vladimir Putin to be keen to ensure calm in Georgia, Russia's fractured Caucasian neighbour. But Mikhail Saakashvili, Georgia's president, as bracingly frank about the Kremlin as he is about his own country's failings, has his doubts. For some Russians, he says, Georgia's breakaway enclaves represent “the last bastion of the fight for the empire.”

The Russians say they respect Georgia's territorial integrity, and want only to keep the peace. “‘Piece-keeping’, not peacekeeping,” says Mr Saakashvili. He predicts that the status of South Ossetia and Abkhazia, the two troublesome regions, will be finalised during his presidency, which may last another nine years. He has a new plan (“win-win”, he says) for South Ossetia, involving autonomy and cash, but not independence.

But Kremlin imperialism is not his only or biggest problem. Many South Ossetians devoutly want either to join Russia or go it alone. Military skirmishes last year revived memories of their war with Georgia in 1991-92, boosting Russia's popularity and that of Edward Kokoity, their leader. Mr Saakashvili's strong rhetoric worries them; so does what one western diplomat calls the “Potemkin autonomy” in Ajaria, another bolshy region tamed by Mr Saakashvili. After a spate of reciprocal kidnappings by South Ossetians and Georgians last month, the so-called “frozen conflict” looks more likely to unfreeze than be resolved. (Abkhazia, whose own post-Soviet war included ethnic cleansing, will be even tougher.)

The death last week—supposedly from gassing by a faulty heater—of Zurab Zhvania, Georgia's prime minister, is another blow to unification. The president describes Mr Zhvania as his political mentor; others saw him as a rival and restraining influence on him. Mr Zhvania was also a respected mediator with the enclaves. Mr Saakashvili's new prime minister, subject to ratification by parliament, will be Zurab Noghaideli, formerly the finance minister.

Gas heaters, like other things, do tend to malfunction in Georgia. But to many Georgians, the notion that Mr Zhvania's death was an accident is laughably naive. The circumstances were certainly fishy. Some detect an effort by hostile—perhaps “external”—forces to destabilise the country, and Mr Saakashvili's presidency. Naturally, there are other theories. Perhaps an FBI team that has flown in from America will clear things up.

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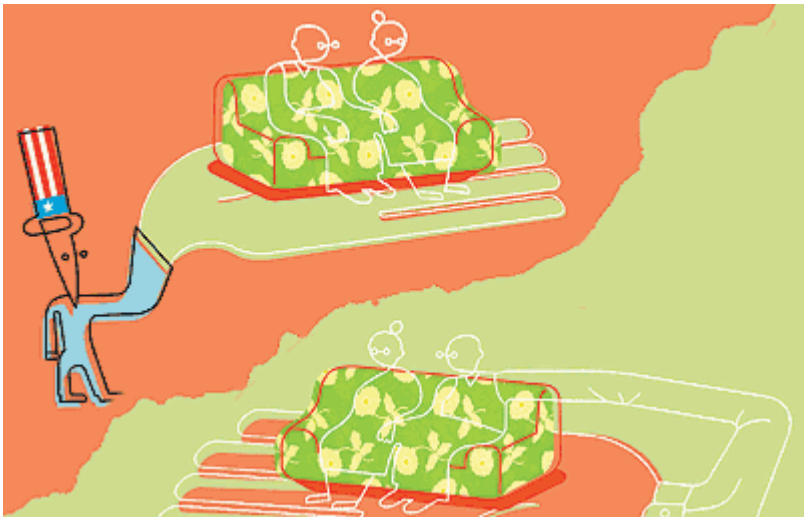
Reshaping Social Security and the budget

Escaping the shadow of a reckless past

Feb 10th 2005 | WASHINGTON, DC
From The Economist print edition



Will George Bush's economic policy be more prudent in his second term than it was in his first?

LISTEN to the president talking about economic policy nowadays, and it is easy to forget that his first term was the most fiscally reckless in decades. The man who presided over the biggest spending increases since the 1960s is touting his new budget as the "most disciplined proposal since Ronald Reagan". The man who has never vetoed a spending bill boasts about cutting 150 federal programmes. The man who signed an extraordinarily expensive give-away to the elderly is now bent on sorting out the Social Security system.

Has the profligate president seen the light? George Bush's budget and his pensions plan suggest different answers. The budget is not as tough as the president is making out: for instance, his proposal manages to halve the deficit by 2009 only with the help of some dodgy accounting, such as leaving out estimates for the cost of fighting in Iraq and Afghanistan. But with Social Security, Mr Bush seems genuinely committed to sorting out the system's long-term finances. Yet he faces an uphill political struggle to get it through Congress, one made more difficult by the fiscal recklessness of his first term.

Certainly, the new focus on deficit reduction is overdue. At 3.6% of GDP in 2004 and perhaps the same again in 2005, the budget deficit is exacerbating the country's reliance on foreign borrowing and worsening broader global imbalances.

Halving that deficit over four years, as Mr Bush vows to do, would be a good start, but the real problem lies beyond that time-frame. As Kent Smetters, a former Bush Treasury official now at

the Wharton School, points out, the first-term tax cuts and spending decisions have worsened America's long-term fiscal imbalance by three times more than the pensions shortfall that the president is so worried about.

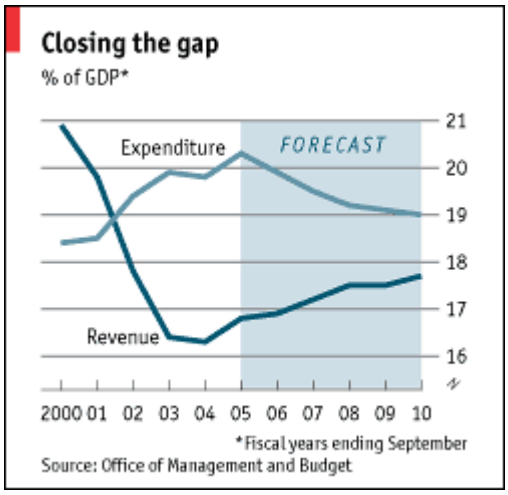
This budget may well make the longer-term mess worse. Mr Bush remains committed not only to making his existing tax cuts permanent (technically the 2001 and 2003 tax cuts expire by the end of 2010) but also to pushing yet more new ones. For instance, the budget wants to introduce special tax-sheltered accounts—"lifetime saving accounts"—that would in effect eliminate the taxation of saving for most Americans. That might be a laudable goal, but it could eventually cost 0.3% of GDP each year.

Both the extension of the existing tax cuts and Mr Bush's new proposals have a modest effect over the next five years, but a big one thereafter. Budget watchers at the Centre on Budget and Policy Priorities, a liberal think-tank, reckon that the tax cuts proposed in Mr Bush's budget would worsen America's fiscal outlook between 2010 and 2019 by $3.3 trillion.

The new tax proposals are unlikely to pass: Mr Bush tried the savings accounts last year—and they got nowhere. But it is hard to work out why a president who wants to overhaul the tax system is proposing more wheezes in advance of such an overhaul. And the budget also excludes tax cuts that are almost certain to occur over the next five years. Include a fix to the Alternative Minimum Tax, which will otherwise clobber almost 30m people by 2010, and even the modest goal of halving the deficit by 2009 becomes elusive.

If Mr Bush's determination to cut taxes come what may seems unchanged, his control of spending is not as draconian as he claims. His budget promises that discretionary spending—the money that Congress appropriates on an annual basis—will rise by less than the rate of inflation over the next five years. To make room for increases in defence and homeland security spending, other domestic spending will be frozen in nominal terms.

Unfortunately, Mr Bush has laid out how to do this only for 2006 (after then he offers no breakdown by department or programme). In 2006, defence spending is scheduled to rise by 5% and homeland security spending by 3% while other programmes are to be cut by 1%. The pain is spread widely, from the elimination of rail subsidies to reducing the myriad of community development programmes.



Congress will howl about this, but many of these things are ripe for the chopping block. Indeed, some conservatives are whingeing that Mr Bush is still throwing money at his pet priorities, such as community health centres. But the real point is that even if Mr Bush was more savage, it would barely change the long-term fiscal picture: domestic discretionary spending outside defence makes up less than 20% of federal spending.

Real restraint means tackling the "mandatory" spending programmes, from farm subsidies to Medicare, whose cost rises automatically from year to year. Mr Bush has made an effort: he wants to cut mandatory spending by $137 billion over ten years, with the biggest cuts ($60 billion) coming in federal contributions to Medicaid, the state-run health plan for the poor. He also proposes to cut farm subsidies by $8 billion, to the fury of Republican senators from farm states.

All good stuff, but in the end the only way to reduce mandatory spending is to reshape the two big entitlement programmes for old people: Medicare and Social Security. Medicare, the health

Other countries' pension policies

Horror movies? Not really

Feb 10th 2005
From The Economist print edition

Actually, the international experience isn't as scary as the Democrats imply

FOR Americans, individual retirement accounts may seem a leap in the dark. But other countries have already made that leap. Opponents of George Bush's reforms, from the AARP old people's lobby to the *New York Times* and just about any Democrat with an atlas, like to suggest that "privatising pensions", as they put it, has always been disastrous. Is that really true?

Start with Chile, the trailblazer. In 1981, it redesigned its pension system around mandatory saving into individual accounts. Many other countries in Latin America followed in Chile's wake.

A recent study by World Bank economists concluded that these reforms were "a major step forward". The new pension systems are a big improvement on pay-as-you-go schemes that were generally mismanaged and financially unsustainable. Not everything is perfect. One worry is that too few workers are covered by the new pension arrangements. Another is that the charges for running the accounts have been too high. Even so, real returns on the pension funds have generally been impressive and government budgets have been improved. And in Chile, economic growth was given a boost.

However, Chile's experience is not necessarily relevant to the United States, points out Monika Queisser, a pension specialist at the OECD. First, Chile made individual accounts the centrepiece of the new pension system, whereas they will form only part of America's public pension provision under Mr Bush's proposals. And, second, the old Latin American pay-as-you-go schemes were in a much worse state than Social Security.

It is probably better for Americans to look at other rich countries rather than developing economies. In Sweden, for example, workers put 2.5% of their eligible earnings into private retirement accounts; this is on top of 16% paid into the main pay-as-you-go scheme. Charges for the new accounts are being held down, but the Swedes got off to a rocky start because they started to invest in 2000, when stockmarkets turned down. Things have been happier in Australia, where 9% of workers' eligible earnings are paid into individual accounts: the reforms, which began in the late 1980s, have also raised saving.

However, in both Sweden and Australia, as in Chile, the new accounts are mandatory, while in America they will be voluntary. To find out how voluntary accounts have worked, Americans need to look at Britain, where Margaret Thatcher introduced them in 1988.

That should be enough to put them off the idea for good, according to Mr Bush's critics. In their version of history, Britain's experience was a disaster, in which people who opted for individual accounts were made worse-off by pension mis-selling. Fortunately, the critics are wrong.

To be sure, pensions were mis-sold in the late 1980s and early 1990s: the bill for putting things

right was £12 billion ($22 billion). But the mis-selling was out of employers' defined-benefit plans, not out of the state system. Many people were lured away from generous employers' plans into funded individual pensions when they would have been better off staying with their employers' schemes. “Mis-selling was not about people being sold private pensions when state pensions would have been better for them,” says Philip Booth, the editorial director of the Institute of Economic Affairs, a think-tank.

Britain's mis-selling scandal occurred within a distinctive pension system that had long allowed employers to provide part of the overall state benefit in return for rebates on part of their payroll taxes. In the late 1980s, this right to “contract out” was extended to individuals, who were also given the right to leave their employers' plans. In America, as Olivia Mitchell, a member of Mr Bush's pensions commission in 2001, points out, there is no “contracting out” for private workers in Social Security and the new individual accounts will form part of Social Security.

What about high charges? Here the critics have more of a point: charges have been a drag on the performance of individual accounts in Britain, as in many other countries. But Mr Bush is well aware of this. His aim is to keep fees as low as 0.3% of fund values by centralising the administration of the new accounts.

Britain does offer one lesson—about cutting benefits through changes to indexation. In 1980, the Conservative government started “uprating” the first-tier basic pension benefit with prices rather than wages (which rise faster). Pensioners may not have noticed at the time, but eventually they got cross. The Conservatives now back restoring the link to earnings. There is a surprisingly wide consensus that state pensions have to be made more generous. “Fiddling with indexes may work in the short term,” says David Blake, director of the Pensions Institute at City University's Cass Business School, “but in the long run it fails the test of political sustainability.”

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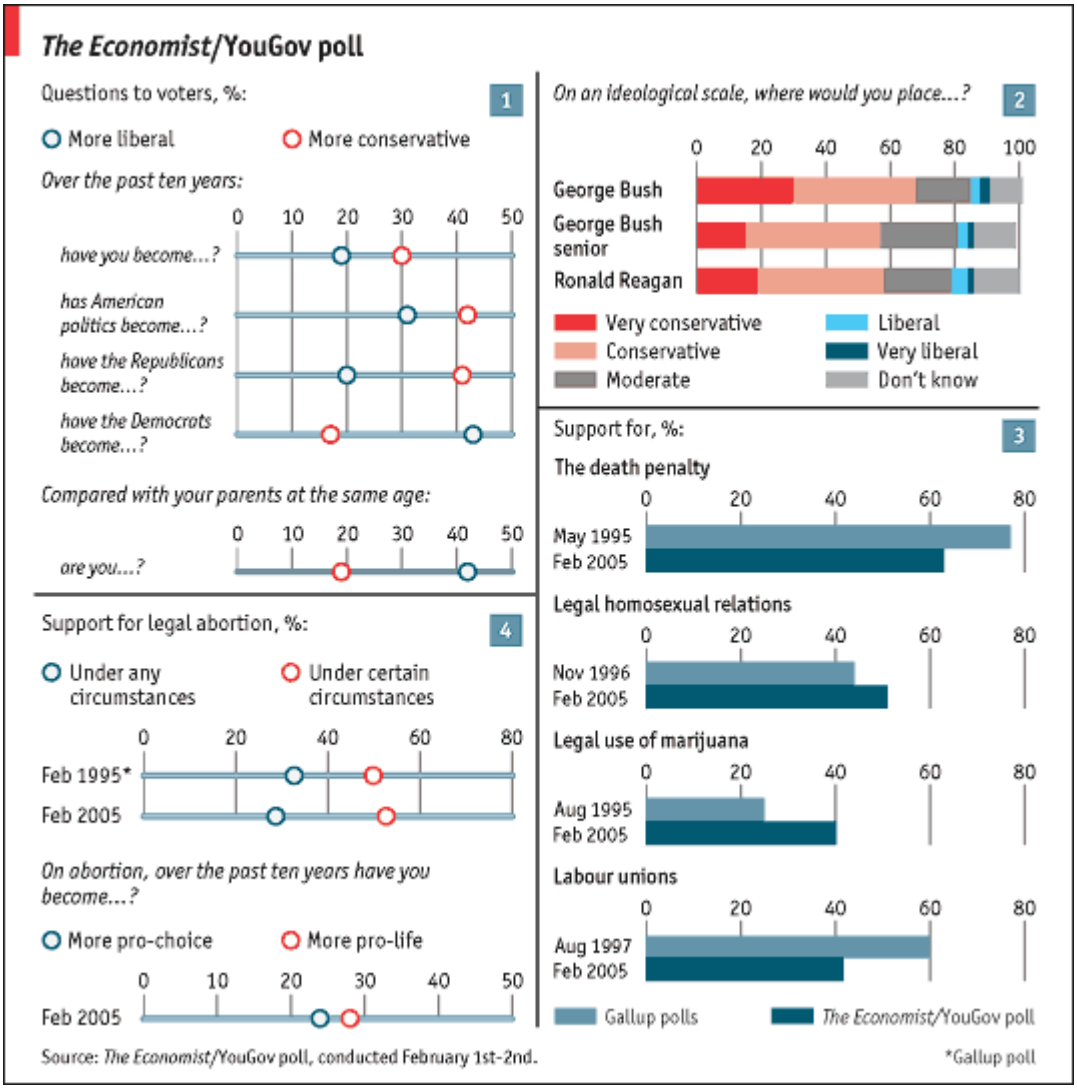
Social attitudes

Not quite right

Feb 10th 2005
From The Economist print edition



Americans seem to believe that they and their politics have got more conservative; but perhaps they haven't

HAS American politics moved to the right? The charts above show figures from a new survey of 2,116 Americans by YouGov, a British-based internet pollster. They seem to reveal a somewhat schizophrenic tension in the body politic. Many Americans think that they and their politicians have become more conservative; yet, when it comes to some fundamental questions, they have

actually shifted to the left.

In terms of self-analysis (see panel 1), the direction is fairly clear. A plurality of Americans (41%) think they have not changed much; but, out of those who have changed, 30% have moved to the right, and only 19% to the left. The main swing rightwards has been among males, the old and, perhaps inevitably, Republicans.

A plurality also think that politics in general has moved to the right over the past decade; and so, they reckon, has the Republican Party, which has gradually increased its hold over national politics during that period. As for presidents (panel 2), George Bush is seen as a more conservative figure than Ronald Reagan—and much more so than his father.

The Democrats seem harder to pin down. Overall, Americans think the party has drifted to the left, but that change has been detected only by Republicans (68-8%). Democrats themselves narrowly think they have become more conservative (27-25%). In all, only one in four people wanted to be characterised as liberal; one in three chose conservative.

Yet one answer in panel 1 offers the American left some hope. By a huge 42-19% margin, Americans think they are more liberal than their parents. And this is borne out by most of the questions in panel 3. Set alongside the replies to an identical set of questions asked by Gallup in 1995-97, Americans seem less supportive of the death penalty and more tolerant of both marijuana and homosexuals. On economic issues, they look less favourably on trade unions, but the number who think they pay too much tax has dropped from 66% to 56%.

As for the biggest culture war of all—abortion (see panel 4)—the picture is hazy, but somewhat similar. Americans claim to have become more pro-life, and the number supporting abortion under any circumstances has gone down marginally. Yet the number who would keep abortion under certain circumstances has risen.

For some conservatives, these numbers may cause a fear which coincidentally provides their movement with much of its impetus: that, though they are winning elections, they are losing at least some of the culture wars. After all, gay marriage was not even a political issue ten years ago. But they can take some cheer from looking overseas. Even if Americans have become a little more liberal on issues such as the death penalty, they are still well to the right of those soppy Europeans.

The full results of *The Economist*/YouGov poll are here.

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Chicago

Has young Daley got the point?

Feb 10th 2005 | CHICAGO
From The Economist print edition

His father never really cleaned up Chicago. Junior says he will

AFP

Now start scrubbing

THIS is a tale of two cities. One is prosperous, a place proudly reaching for the sky and confident that it catches the world's eye. The other is old-fashioned and corrupt: officials take pay-offs for city contracts, workers do patronage jobs and federal indictments are regular news. They are, alas, two faces of the same coin: Chicago. But they are increasingly at odds with each other. On February 8th, Mayor Richard Daley announced that he intends to prevent the stain of crooked old Chicago from spoiling the new city's gleam.

Acknowledging that a series of scandals threatens to overwhelm his 15-year record in office, the mayor of America's third-largest city said he would replace a corrupt programme to hire trucks from contractors, and would ban campaign contributions from companies and people who do business with the city. A few days earlier he had announced the hiring of new managers to crack down on fraud.

There is much to admire in the new Chicago. It has lately added dashes of world-class style with Frank Gehry's and Anish Kapoor's work at the new Millennium Park. Luxurious residential towers are mushrooming downtown. Once scary patches of the south and west sides are being gentrified. The globe-trotting mayor touts his beloved city from Shanghai to Paris as a good place to do business.

Yet pick up a local paper, and it's like stepping back in time. Government scandals unfold with jarring regularity. One day it is abuse of the city's affirmative-action contracting programme, when a contractor with ties to Mr Daley pleads guilty to defrauding the city. Another day there is a new federal indictment about those hired trucks. Last week a police commander with alleged mob ties was charged with lying to federal agents.

Few believe the mayor himself has done anything improper. But many remember his father, the earlier Mayor Richard Daley, who dazzled the city with public-works projects while fighting a series of scandals between 1955 and 1976. Daley senior rolled with the scandals until they appeared to threaten his own position, and then banged his fist—for instance, shaking up the police department after some cops were caught burgling city businesses.

Some things have changed since then. The current Mr Daley, in office since 1989, relies not only on the city's old political machine, where ward bosses dole out favours and the city council virtually rubber-stamps his requests, but also on newer support from rich businessmen, who came

up with millions of dollars to complete a much-enhanced Millennium Park. It seems fitting that the mayor and his wife are moving out of their home in Bridgeport, long the base of the Daley dynasty, to a condominium in the business district.

Still, the mayor remains almost unchallenged in the city council. His circle includes few independent spirits. As one former Daley aide puts it, what's the incentive for a talented person to work for him if you're just a cog in the wheel?

Chicagoans have long been tolerant of political shenanigans, but with the city's finances in their worst shape in years the connection between government waste, bad services and higher taxes is getting more obvious. “People are no longer willing to accept the status quo,” says John Fritchey, a state legislator whose district is in Chicago. This week's declaration suggests that Mr Daley has got the message.

The mayor clearly loves his job, and would like to run for another four-year term to match his father's six elections as mayor. But the stress of public life and private pains—his wife has had cancer—is starting to tell. This week could decide whether this Mayor Daley is remembered for finally turning old Chicago into a stylish, economically vibrant global city.

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Gay marriage in New York

No, but maybe yes

Feb 10th 2005 | NEW YORK
From The Economist print edition

The city's mayor goes deliberately ambivalent

AP

LAST year San Francisco's Mayor Gavin Newsom began handing out marriage licences to any gay couple who wanted one, only to find himself in a mess when California's courts ruled that the licences had no legal validity. Now New York's Mayor Michael Bloomberg has taken the opposite line. The Republican mayor is appealing against a lower court's decision allowing the city clerk to issue marriage licences to homosexuals (this contradicted two recent court decisions elsewhere in the state) while at the same time promising to push for a change in New York's laws.

This has brought predictable snorts from his opponents. The city council's Democratic speaker (and would-be mayor), Gifford Miller, has joined the crowd calling the mayor a coward. Another Democrat, Fernando Ferrer, Mr Bloomberg's most serious rival in the next election, calls him “opportunistic”. And a fellow Republican, Thomas Ognibene, who would also like the mayor's job, has called him “spineless”.

Legal recognition of a marriage has many practical consequences in America. There are, according to one gay-rights group, 1,100 federal benefits directly tied to marriage, to say nothing of hundreds more provided by states and private employers, as well as rights connected with inheritance and insurance coverage. All this adds to the homosexuals' argument for recognition of their marriages.

If the case now goes directly to the state's highest court, there will either be a full judicial endorsement of gay marriage, which Mr Bloomberg would endorse, or (more likely) the opposite. At present the state's law, as the plaintiffs acknowledge, is quite clear in not permitting same-sex marriage. However, in ruling in favour of five couples who last summer demanded marriage licences from the city clerk's office, the lower court said the law was unconstitutional on two grounds: failure to provide equal protection (by treating people differently because of their sexual orientation); and failure to provide due process (by failing to allow people the right of privacy to arrange their marriage free of unjustified government interference).

These arguments touch on difficult areas of law, and so far have arisen primarily in abortion and sodomy cases; the results have left neither side really happy. The Bloomberg approach, if successful, might ultimately encourage an endorsement of gay marriage to come about through the legislature, by a change of law backed by political will and public opinion. That will not be easy

to achieve. Only a third of the people in New York state, on the evidence of current opinion polls, are in favour of gay marriage.

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Covenant marriages in Arkansas

Yes, I really do

Feb 10th 2005 | LITTLE ROCK
From The Economist print edition

An uxorious state governor urges his people to stay married

UNTIL death do us part: well, up to a point, anyway. On Valentine's Day, February 14th, the governor of Arkansas, Mike Huckabee, and his wife Janet will hold a party for more than a thousand couples who think that a mere “I do” amounts to minor-league marriage. The Huckabees, who have been married for 30 years, will renew their wedding vows at a mass “covenant-marriage” ceremony in a local sports arena. Other couples will sign a covenant-marriage declaration of intent which, once filed at the courthouse in the county where they live, converts ordinary marriages into a deeper commitment.

In 2001, Arkansas passed the Covenant Marriage Act. Couples who choose this path are required to agree to pre-marital counselling by a clergyman or a therapist and a two-year “cooling-off” period before a divorce can be granted. The only exceptions are the three As: abuse, abandonment or adultery. Couples hit by one of these qualify immediately for judicial separation, but still have to wait two years for a divorce.

Arkansas followed the lead of neighbouring Louisiana, the first state to enact covenant-marriage legislation, in 1997, and Arizona, which did it in 1998. Last year Iowa passed a pre-marital counselling law. Arkansas has the second-highest divorce rate in the country. Only Nevada, with its quickie divorces, beats this Bible-belt state.

Mr Huckabee is going centre-stage because he wants his state's divorce rate halved in ten years. A Southern Baptist minister turned politician, he is urging couples to think twice about marriage (hence the pre-marital counselling) and, if they do get hitched, to realise that parting is not just a matter of signing a piece of paper and dividing up the music collection. Things are not going all that fast. So far, in three years, only 600 Arkansas couples have chosen a covenant-marriage licence. The state has more than 40,000 marriages a year.

The point of covenant marriage is not to make divorce impossible (a couple can always travel to another state and do it there) but to make it harder. In a covenant marriage, a person cannot refuse counselling to save the marriage; that would be in breach of the covenant. In the past few months, many Arkansas churches have been urging their congregations to covenant their marriages, with testimonials from couples who have already accepted the tighter bond. Mr Huckabee has taken part in public- service advertisements for the Valentine's Day event, which will involve some well-known churchmen from around the country and CeCe Winans, a Grammy-award-winning gospel singer.

Many Arkansas couples will share chocolates and champagne on Monday, and profess their love with furry teddy bears. Others will get into a church bus to go to the Huckabees' celebration and sign a legal document. Less romantic, maybe, but probably longer-lasting.

Lexington

From Bill to Howard

Feb 10th 2005
From The Economist print edition

How on earth did it happen?

BACK in 2003, with Howard Dean way ahead of the pack in the race for the Democratic presidential nomination, the cover of the conservative *National Review* pleaded “Please, nominate this man”. The Democratic caucus-goers of Iowa were sensible enough to ignore this advice, consigning Mr Dean to third place. Earlier this month, with Mr Dean once again way ahead of the pack, this time in the race for the chairmanship of the Democratic Party, the *National Review* tried again: “Pretty please”. Yet on Saturday the Democratic National Committee is almost certain to elect Screamin' Howard as its new chairman.

This is an extraordinary turn of events, particularly for Bill Clinton and pragmatic New Democrats. Five years ago the Democratic Party was so firmly in the grip of those oh-so-sensible types that Jesse Jackson, the chief screamer of the time, pronounced himself a “New Democrat”. The Dean chairmanship shows how little Mr Clinton actually managed to change his party. The fact that Mr Dean is replacing Mr Clinton's lapdog, Terry McAuliffe, makes this even clearer.

Does Mr Dean's accession really mark a lurch to the left? Optimistic Clintonites and centrists are clinging to two arguments. The first is that the party chairmanship doesn't amount to a hill of beans. Alas, it does. Party chairmen are responsible for running the political machines that increasingly make the difference between winning and losing elections in a closely divided nation. They also have a chance to become the public face of their party—at least until a presidential nominee emerges. It is hard to imagine that Mr Dean will keep out of the limelight.

The second argument is that the distance from there to here really isn't all that great. Already, some Clintonites have some reassuring ideas. Wasn't Mr Dean really a centrist governor of Vermont? Didn't even the great Bill sometimes pander to the left? And isn't Mr Dean free to reposition himself in the centre? This also looks dubious. Even if you accept the idea that being a moderate governor of one of the most left-wing states in the union qualifies you as a centrist, Mr Dean no longer has either the will or the wherewithal to reposition himself in the centre.

Mr Dean thrives on the adulation of the party's hard-core activists. And he burned himself into the national consciousness as a tribune of the left. A man who said that Osama bin Laden should not be presumed guilty until after a fair trial is always going to be beyond the pale for many Americans. A man who opposed the Iraq war so trenchantly is always going to reinforce the idea that Democrats are soft on defence.

Besides, the Democrats have ended up with Mr Dean precisely because the party is in the grip of a populist uprising. The Democratic establishment—from the Senate to the governors' mansions and from the lobbyists to the political consultants—is dead set against him. Mr Clinton reportedly lobbied Mr McAuliffe to stay on and then approached another former adviser, Harold Ickes, to run for the job. But the establishment doesn't elect the party chairman: the 447-strong national committee does. And these people represent the party's base—organisers and activists from blue states or the blue bits of red states (one of them is an 18-year-old high-school senior from Wisconsin).

Mr Dean recently summed up his appeal to the party's populists in a single sentence: “I hate the Republicans and everything they stand for, but I admire their discipline and their organisation.” These populists want somebody who can rage against Republicans. But they also want someone who can out-organise them. Mr Dean's admirers point out that his internet-based presidential campaign raised more than $50m, almost entirely in small donations. That was far more than established figures like Joe Lieberman and Dick Gephardt got. Even after he dropped out of the presidential race, Mr Dean helped to raise about $3.5m for his fellow Democrats.

Mr Dean has solidified his image as a sugar-daddy by promising to provide $11m from the national committee to pay the salaries of state party employees. All the same, his organisational skills should not be taken as a given. His former pollster, Paul Maslin, remembers him as a man whose “erratic judgment, loose tongue and overall stubbornness wore our spirits down”. Other insiders note that Mr Dean's wired campaign was really the work of his campaign manager, Joe Trippi, who pointedly endorsed somebody else for the party chairmanship. As for the idea that “hatred of the Republicans and everything they stand for” is going to win over the exurbs, that beggars belief.

Once more into the wilderness, dear Democrats

Why didn't the Clinton revolution prove longer-lasting? Some of it is Mr Clinton's own fault: his policy of triangulation inevitably alienated the party's leftists (however much they rallied round him over Monica). It is partly the fault of the New Democrats, who were always more interested in policy discussion than in mass organisation. It is partly a result of Mr Bush's hardball politics: whenever centrist Democrats have tried to compromise with Mr Bush, he has taken all they have to offer and given nothing in return. And it is partly to do with a genuine shift of political power away from old-style money-raising. Mr Clinton and Mr McAuliffe were master-schmoozers of the money-men. But the money-men have lost their power to veto candidates like Mr Dean, because the internet has provided mavericks with a way to bypass them.

Perhaps the New Democrats will turn out to have more fight left in them than they now appear to possess. Perhaps a charismatic centrist—Hillary Clinton, for example—will ride to the rescue. But at the moment it looks as if the Democrats are in exactly the same state as the British Labour

Party was in after their 1987 defeat—in need of one more humiliation before it can come to its senses. If so, they have chosen the right man in Howard Dean.

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Drugs in Latin America

Battles won, a war still lost

Feb 10th 2005 | BOGOTA, LIMA AND MEXICO CITY
From The Economist print edition

Reuters

New and dangerous trends in the Andean drug business

LOOKED at in one way, these are good times for America's drug warriors, at least with regard to cocaine. Traditionally, some 70% of the white powder has come from Colombia. The $3 billion in aid that the United States has spent there since 2000 under Plan Colombia has produced what American officials present as some spectacular numbers—especially since Álvaro Uribe became president two years later and allowed large-scale aerial eradication of drug crops.

At the last count by the United Nations, in 2003, land under coca in Colombia was down to 86,300 hectares (213,200 acres) from a peak of 163,300 hectares in 2000. In 2004, contractors working for the United States sprayed herbicide on 136,555 hectares of coca, a similar amount to the previous year. That points to a further decline in cocaine production last year, according to John Walters, who heads the United States Office of National Drug Control Policy (ONDCP).

In 2004, almost 150 tonnes of cocaine were seized in the country, a third more than in 2003, while 1,900 cocaine labs were destroyed, 40% more than in 2002. Mr Uribe has extradited 166 Colombians to face drug charges—and probably a life behind bars—in the United States. They include Gilberto Rodríguez Orejuela, who as head of the Cali drug mob ruled the trade a decade ago. American officials say that they have squeezed the drug revenues of the FARC guerrillas and their right-wing opponents, the AUC. “We're moving in one direction. The bad guys are losing and the people in Colombia are winning,” says Mr Walters. Those who see it otherwise “want this thing to fail”.

Yet to many people across and beyond Latin America, the Andean drug trade seems as effective and dangerous as ever. The most telling evidence is the price of cocaine. According to the

Washington Office on Latin America, an NGO, the ONDCP's own figures, released to Congress but not yet to the public, show that in the United States a gram of cocaine wholesaled for $38 in 2003, down from $48 in 2000 and from $100 in 1986, with no fall in purity. In Britain, cocaine is cheaper than ever: in 2003 it retailed for about £46 per gram ($75), down from £57 ten years ago, according to the Independent Drug Monitoring Unit, a consultancy. Prices have fallen even as world demand has risen: consumption is broadly flat in North America, according to the UN, but rising in Europe. It is rising, too, in Brazil, Mexico and Central America, mainly because smuggling gangs are being paid in product.

An evolving trade

What is the explanation? Bigger-than-anticipated stocks along the supply chain mean that there is a lag between a fall in output and its effect on prices, say American officials. Just wait to see the effect of Plan Colombia, they say. But others argue that the headline figures for hectares sprayed do not tell the full story. An alternative explanation is that coca has spread to new areas, some undetected, and that yields and productivity are rising.

According to the UN, Plan Colombia produced a modest displacement of coca to other countries: by 2003, cultivation was up slightly in Bolivia but stable in Peru. Even so, land under coca in both these countries was far below its peak of a decade ago. Overall, the UN calculated that the total potential output of Andean cocaine was 655 tonnes in 2003—a big fall from a peak of 950 tonnes in 1996.

Yet in both Peru and Bolivia, the drug warriors now face troubling new trends. In Peru, the second-biggest producer, coca is spreading to new areas, such as San Gabán, close to the border with Bolivia, and Putumayo, across the river from Colombia. Between them, these may account for up to 10,000 hectares of new coca. Local-market prices for coca leaves are rising. In the distorted economics of an illegal business, that is a sure sign that repression is failing to restrict effective demand. In December 2004, the price of a kilo of coca leaves on the illegal market had risen to $5 from a low of 50 cents, according to the Peruvian government's anti-drug agency, DEVIDA. This will lure farmers into planting more coca, says Nils Ericsson, DEVIDA's director. At current prices, a hectare of coca yields an annual income of up to $7,500, compared with $600 from coffee or $1,000 from cocoa.

Peru's cocaine industry is vertically integrating. A decade ago, small aircraft ferried semi-processed coca paste for refining in Colombia. Now, Peru's output of refined cocaine is soaring. Last year, for the first time, police seized more powder than paste. They have destroyed more than 1,700 cocaine laboratories in the past two years. This switch to refining is being pushed by Mexican drug groups which, according to prosecutors, were helped by Vladimiro Montesinos, Peru's jailed former spy chief. For the Mexican gangs, buying finished cocaine is cheaper and involves less risk, says Fernando Rospigliosi, a former interior minister. Much of the refined product is now going straight to Mexico or Spain on cargo ships, concealed in Peru's booming legal exports. In November, 700 kilos were found stuffed inside frozen giant squid. Other shipments have been found in planks of wood, carrots, guano and even votive candles.

Peru's government says it wants to eradicate all but 10,000 hectares of coca, which are reserved for traditional use, by the end of 2006. But there are signs that the drug trade is once again spreading its trail of corruption to the security forces. According to testimony from some of those arrested for the shipment of stuffed squid, the deal was planned at a club for army officers and the drugs packed at a naval base near the northern port of Paita.

Peru does not allow chemical spraying of coca. Instead, it has mixed manual eradication with schemes to encourage

farmers to pull the crop up and plant legal alternatives. This approach suffered a setback last year when angry coca farmers expelled UN agronomists from Monzón, one of the main coca valleys. The United States' draft budget for next year includes a cut of $18m in aid for “alternative development” in Peru. That puts more onus on forcible eradication—a challenge for a weak and unpopular government.

A setback in Bolivia

Political fragility has complicated the drug war in Bolivia, too. An aggressive American-backed campaign of manual eradication in the late 1990s wiped out most of the country's illegal coca. But this contributed to a slowdown in the economy and discontent, which culminated in the overthrow of Gonzalo Sánchez de Lozada, a pro-American president, in 2003. Since then, the United States has adopted a softer approach. In October, Carlos Mesa, the new president, reached an agreement with the coca growers of the Chapare, allowing them for the first time to keep 3,200 hectares of coca legally in return for eradicating the rest. Governments have refused to allow eradication in the Yungas, the main area of legal cultivation, where illegal coca is reported to be expanding.

Curiously, Ecuador has never grown much coca. But it has become a transport and service hub for the drug industry. Since it adopted the dollar as its currency in 2000, Ecuador has become even more convenient for laundering drug profits (though most of this still happens in the United States and Europe). Around a third of Colombia's cocaine is now reckoned to be exported through Ecuador, mainly through the port of Guayaquil. Seizures of drugs in outbound shipping from Ecuador's ports fell to just 4 tonnes last year, from 12 tonnes in 2003. Nobody believes that is because less is being exported.

Mexico, too, is feeling the ripple effect of the drug trade as never before. A surge in drug-related violence along the northern border with the United States has included the kidnapping and killing of several American citizens. That prompted America's State Department last month to issue a travel warning. “Exaggerated,” said Mexico's government, which recently sent several hundred troops to the border state of Tamaulipas to try to restore confidence.

Behind the violence lie turf wars. A decade or so ago, three or four big Mexican smuggling syndicates became equal partners with Colombians in the supply route to the western United States. The government of President Vicente Fox has made much bigger efforts than its predecessors to tackle these syndicates, clean up the security forces and collaborate with American drug fighters. Several notorious drug barons, such as Benjamín Arellano Félix, have been jailed.

One consequence is to transfer the drug business and its feuds to prisons. “Lawyers” relay orders from jailed bosses. In January, the army took over a maximum-security prison near Mexico City after the murder of the brother of a fugitive drug boss sparked a riot. The government has since sent several inmates to other jails. Six warders were murdered at another prison, this one at Matamoros in Tamaulipas.

As in Colombia a decade ago, the weakening of the big syndicates in Mexico has merely resulted in them being replaced by scores of smaller, nimbler outfits, which are harder to detect. As always, the drug business appears to be one step ahead of its pursuers.

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Drugs in Canada

Under the needle

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A different approach to addiction

AP

Vancouver's potentially productive citizens

LITTLE by little, Canada is groping towards a distinctive approach to drugs, one that focuses on harm reduction rather than the repression favoured by the United States. The federal government is mulling over a bill to decriminalise possession of marijuana. North America's first trial of heroin maintenance—giving addicts free heroin on condition that they accept treatment—got under way on February 10th in Vancouver. Later this spring, it will expand to Toronto and Montreal.

An otherwise idyllic city, Vancouver has the worst drug problem in Canada. For years, addiction has been rising, and with it gang killings, violent robberies and break-ins. In 2002, fed-up citizens swept in a reformist city council dedicated to an alternative drug strategy, resting on “four pillars”: harm reduction, treatment, enforcement and prevention.

Its first move was to open North America's first safe heroin-injection site, a pilot project which, it is claimed, is curbing disease and deaths among addicts. Now comes the North American Opiate Medication Initiative (NAOMI), a two-year C$8m ($6.5m) study funded by the Canadian Institutes of Health Research, a federal agency. In the three cities, the project will enrol 470 “treatment-resistant” addicts (meaning that they have been addicted for at least five years and have at least twice had treatment without success). Half will receive methadone, an artificial opiate; the others will get daily injections of heroin. After a year, those who have not broken their drug habit will be referred for further treatment. All will get help with health, housing and job training.

One aim is to determine whether heroin maintenance is more effective than methadone in helping break addiction. More broadly, NAOMI will test whether heroin maintenance, which is used in Switzerland and the Netherlands, will work in North America. The hope is that if hard-core addicts no longer have to commit crimes to fund their habits they are more likely to become productive citizens and leave drugs behind. In the Swiss and Dutch trials, says Martin Schechter, of the University of British Columbia, the addicts involved “reduced their use of street drugs, their health improved, the level of employment went up and the levels of criminality fell drastically.”

Researchers in three American cities were keen to take part in the study but found it too controversial for them to obtain funding. If the scheme turns out to save money as well as lives, Canadians are likely to want it to become permanent. By some counts, the total bill for enforcement of drug laws plus the cost of drug-related property crimes and health care for addicts amounts to at least C$5 billion a year. Researchers reckon that heroin maintenance will be

cheaper.

NAOMI's promoters expected resistance from police chiefs and the opposition Conservative Party. In fact, reaction has been muted. Both have called for careful evaluation of the research. But while many Canadians agree with trying to reduce the harm associated with drugs, they also want a balanced strategy that includes those other three pillars: treatment, prevention and enforcement.

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Suriname

A lingua franca for a tropical babel

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A debate over language politics

BELGIANS, Quebeckers and Basques may define themselves by language. Not so the inhabitants of Suriname. The fewer than 500,000 inhabitants of this corner of South America share more than a dozen languages in daily use. Conversations—and newspapers—switch effortlessly in mid-sentence.

Dutch, the language of the former colonial power, is used at school and by officialdom, but not much at home. Closest to a national tongue is Sranan Tongo. This is an amalgam developed by the former slave population mixing Dutch and English—Britain once ruled Suriname before short-sightedly swapping it for New York in 1667—with African grammar.

In the interior, there are four Amerindian languages and at least two dialects spoken by *bosnegers*, the descendants of escaped slaves who set up communities deep in the rainforest. Gold buyers in Paramaribo, the capital, erect signs in Portuguese to attract Brazilian *garimpeiros*. Descendants of Indian, Javanese and Hakka Chinese indentured labourers have evolved their own local tongues. Guyanese immigrants speak English. Along the border with Guiana, an overseas *département* of France, there's a smattering of French Creole. Cable television carries programmes in English, Hindi, Portuguese, Spanish and Indonesian Bahasa as well as Dutch.

Last month, Suriname became the third member (after the Netherlands and Belgium) of the *Taalunie*, a Dutch answer to *la francophonie*. But relations between Suriname and the Netherlands are mutually unenthusiastic. Suriname has received much Dutch aid since independence in 1975, but dislikes the strings that come with it.

Nowadays, Suriname's closest links are with the English-speaking Caribbean, whose club, Caricom, it joined in 1995. So last month, three senior politicians, spanning the country's fractious political spectrum, called for a debate over whether to adopt English as the official language alongside, or even instead of, Dutch. They talk hopefully of British or American cash as a reward. But if aid is the motive, perhaps they should be brushing up their French.

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State elections in Mexico

The waiters' revolt

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More pointers to the presidential vote

WHILE tourists lounged in the sun at some of Mexico's top seaside resorts last Sunday, the people fixing their margaritas and cleaning their rooms went to the polls. By coincidence, local elections took place on February 6th in Mexico's most famous beach states: Baja California Sur (home to Los Cabos), Guerrero (the site of Acapulco and Ixtapa) and Quintana Roo (with Cancún and Cozumel). With a presidential vote due in mid-2006, the results were closely watched.

They delivered a shock to the Institutional Revolutionary Party (PRI), which ruled Mexico for seven decades before losing to Vicente Fox in 2000. Despite that traumatic defeat, the PRI has staged a remarkable comeback over the past two years. Last year, it won 11 out of 14 state elections. But Guerrero has bucked that trend. Most pollsters had expected a close result there. In the event, the PRI suffered a drubbing at the hands of the leftish Party of the Democratic Revolution (PRD), whose candidate for state governor won by a 12-point margin. Thus ended 76 years of rule by the PRI in a state of marked contrasts. Acapulco's glittering façades hide a city of slums and a hinterland of mountainous poverty, a breeding-ground of guerrillas, drug gangs and death-squads.

For the PRI, the Guerrero vote carried two worrying portents for 2006. First, a party which traditionally commands the countryside lost in a heavily rural state. Second, the PRD's victory and its retention of Baja California Sur boost the presidential hopes of its standard-bearer, Andrés Manuel López Obrador. In opinion polls, Mr López Obrador, the mayor of Mexico City, has long been the most popular presidential hopeful; hitherto, his chief weakness has been his party, which even now will govern just five of Mexico's 32 states.

In all three elections, there was little to choose between the main candidates ideologically. Mexico's politically contested ground has narrowed. Guerrero's new governor, Zeferino Torreblanca, is a businessman and former mayor of Acapulco. He may allay business anxiety over what a victory for Mr López Obrador might portend for Mexican capitalism.

The Guerrero result tarnished the PRI's success in retaining Quintana Roo, a state troubled by corruption and drug-trafficking. Many in the PRI had been hoping for a smooth ride back to the presidency next year. They have been jolted.

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Dealing with North Korea, again

When the partying has to stop

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Stepping closer to the nuclear brink

THE boss's birthday is an obligatory big event in North Korea. Whether or not the reclusive Kim Jong Il shows up in person for his national shindig on February 16th, the fireworks have begun. North Korea's announcement, not just that it has built nuclear weapons (it has said that before), but that it is suspending indefinitely its participation in six-party talks that America, China and others had been hoping would end its shady nuclear dealings, is an attempt to put the blame on the Bush administration for the nuclear impasse. But it is also a poser for China, which had been expecting to cajole, bribe and drag North Korea into more talks within weeks.

Pulling out of the talks will only deepen North Korea's isolation, said Condoleezza Rice, America's secretary of state. Mr Kim clearly calculates differently. Pressure had been building for him to sit down again, along with South Korea, Japan and Russia, and this time negotiate seriously. North Korea had yet to respond to an American proposal last June that would offer economic assistance and security guarantees, as North Korea has demanded, but only if Mr Kim agrees to the verifiable dismantling of both his nuclear programmes: the plutonium programme that had been frozen until two years ago under a 1994 deal with America, and the uranium-enrichment activity that America accuses him of carrying on in secret, and that led to the latest stand-off.

Instead of slapping down a counter-proposal of his own, Mr Kim has used a string of excuses—America's presidential election (in which he rooted for George Bush's opponent), waiting to see whether Mr Bush sounded “hostile” in his State of the Union address earlier this month (he didn't).

He blames his latest huff on Ms Rice, who recently lumped North Korea among the “outposts of tyranny”.

Until now, China, South Korea and Japan have all been happy to prop up Mr Kim with dollops of aid, so long as he refrained from doing rash things: testing a bomb, for example, or another of his far-flying missiles. South Korea has forged ahead with economic co-operation, including links across the otherwise heavily fortified border. But letting Mr Kim off the nuclear hook so easily had already started to look increasingly dangerous.

Tests by America's Department of Energy have convinced American officials that North Korea may well have supplied the uranium hexafluoride gas—partly-processed uranium which can be spun in centrifuge machines to make enriched uranium for either civilian or military uses—that Libya turned over to inspectors a year ago when it abandoned its once secret nuclear-weapons programme. The evidence is not irrefutable, but the conclusion is also based on traces of plutonium found on the canisters concerned, as well as a third piece of evidence not so far made public. Earlier this month, America put its case to China, South Korea and Japan—possibly the real reason for Mr Kim's latest tantrum. If the analysis is correct, it puts North Korea just one step away from one of the Bush administration's red lines: the export of weapons-useable material itself.

Until recently, Chinese officials in particular had expressed scepticism that North Korea even had a uranium-enrichment programme. They and others have wanted America to focus on North Korea's known plutonium-making. America accepts that North Korea has probably finished extracting the plutonium (enough for half a dozen bombs) from spent fuel-rods previously stored under the 1994 deal near its nuclear reactor at Yongbyon; it will soon be able to unload more rods from the reactor for reprocessing.

But the idea that America should set aside its uranium concerns is given a bipartisan rebuttal in the current issue of *Foreign Affairs* by Robert Gallucci, who negotiated the 1994 plutonium deal with North Korea under the Clinton administration, and Mitchell Reiss, the just departed head of policy planning in the Bush administration's State Department. Turning a blind eye to evidence of North Korea's enrichment work would, they argue, leave Mr Kim with a covert supply of fissile material, whether for bomb making or for export, including to terrorist groups.

So far, despite its tough line, says Gary Samore, of the London-based IISS, America has in effect acquiesced in North Korea's becoming a covert nuclear power. South Korea recently admitted for the first time that it suspects the North of possessing nuclear weapons too.

But that is only part of the story. Its exports of missiles and imports of illicit nuclear goods are being disrupted on land, at sea and in the air under the American-led proliferation security initiative, which Russia has formally joined and which even China has said a few kind words about. Its collaborators, including Iran and Syria, are coming under increasing scrutiny. Its narcotics and counterfeiting activities are being squeezed too. Meanwhile, there have been reports of political intrigues and even some limited anti-regime protests. Mr Kim may soon pick one of his sons as the next dynast-designate, in part to quell rumours that he is losing his grip.

Lashing out under pressure is a Kim trademark. So is demanding hefty bribes, from China and others, for better behaviour. Mr Kim may yet change his mind again about the nuclear talks. But expect him to take his time about it.

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Japan and North Korea

The dear cheerleader

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North Korean footballers v Japanese politeness

EPA

Kidnap the ref

ON FEBRUARY 9th, Japan hosted North Korea in a qualifying match for the 2006 World Cup. Relations between the two countries have gone downhill during the decade that the Hermit Kingdom has shunned international football, and pre-match tension was stoked when, a few days before the kick-off, Japan flashed North Korea a yellow card by changing Japan's shipping rules. From March, ships over 100 tonnes will be barred from Japan unless they carry insurance for oil spillage. This was aimed squarely at North Korean vessels, only 3% of which are so insured.

Many Japanese have been clamouring for tough economic sanctions against North Korea because of a stand-off over abducted Japanese citizens. Kim Jong Il, the North Korean leader, admitted in 2002 that his regime committed such kidnappings during the cold war. At least eight abductees are unaccounted for, and North Korea only made things worse last November when it returned what it claimed were the remains of two victims, only to be contradicted by DNA tests in Japan.

North Korea, unapologetic as ever, hardly assumed a low profile for the match. It purchased 5,000 tickets for supporters, even though its own citizens cannot leave their country, and urged ethnic North Koreans in Japan to show up and cheer.

To be safe, officials left a demilitarised zone of empty seats between the North Korean section and Japan's famously peaceful supporters, and used far more police (3,500) than they usually do for such matches. After castigating China for letting nationalist supporters abuse Japan's team and fans in Beijing last summer, when Japan beat China in the Asian Cup final, Japan's government did not want its own supporters getting out of hand, however slight the odds.

In the event, Japan won 2-1. North Korea will get another chance in June, however, when the Japanese squad heads to Pyongyang for a return match. The calls for stiff economic sanctions will continue between now and then. But will Japan find the gumption to pull out the red card?

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Thailand

Why they all love Thaksin

Feb 10th 2005 | PAI
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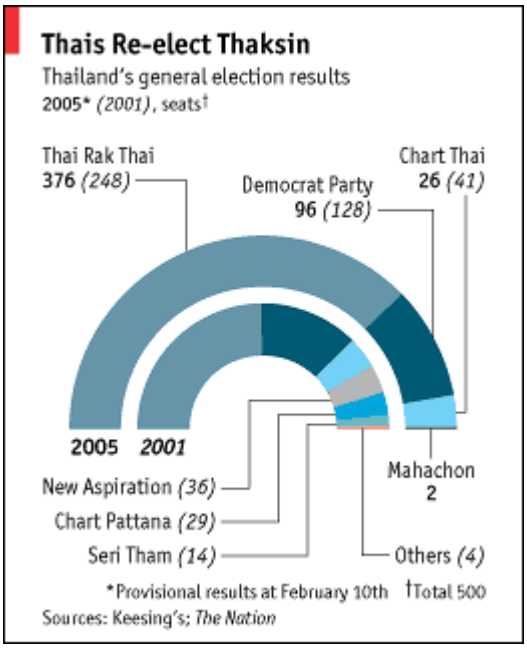
The biggest election win in Thai history

Get article background



FROM an upstairs window, orange-robed monks stared at the crowd gathering at the makeshift polling station in the courtyard of their monastery. Hill-tribe women in colourful costumes and government officials in khaki uniforms stood out amid the mass of farmers and tradesmen waiting to cast their ballots in Thailand's parliamentary election. A Muslim man with a thin beard and a white skullcap rubbed shoulders with an ethnic Chinese woman in a red silk shirt. A limping pensioner rode up on the back of his grandson's motorcycle. For all their variety, however, this group of voters in Pai, in Thailand's rural north-west, had one thing in common: a desire to see Thaksin Shinawatra, Thailand's outgoing prime minister, returned to office.

Mr Thaksin deserved another term, the Chinese woman confided, for his deft handling of the economy. Others mentioned his no-holds-barred war on drugs, and his lavish spending schemes, including cheap health care and micro-credit for villages. Even the one man who admitted voting for an opposition party said he did so only for the sake of checks and balances, and wanted Mr Thaksin to stay in charge.

He got his wish. For the first time ever in Thailand, a single party, Mr Thaksin's Thai Rak Thai, won the election outright. The official results are not known yet, but the projections show TRT sweeping 376 of the 500 seats in parliament. Its nearest rival, the Democrat Party, seems to have won just 96. Only two other parties, out of the 36 competing, won any at all.

The results confirmed several trends from the previous election, in 2001. In most of the country, Mr Thaksin's coat-tails counted for more than dynastic connections or a provincial power-base. Thus only two of the many local grandees on the ticket of the Mahachon party, which split from the Democrats before the election, won seats. But in the south of the country, the Democrats' grip seems as firm as Mr Thaksin's is elsewhere. It took 52 of the 54 seats there. All this has accelerated Thailand's drift towards a two-party system—albeit one which Thai Rak Thai roundly dominates.

Mr Thaksin has already declared that TRT will drop its former coalition partner, Chart Thai, and form a government on its own. (Chart Thai's leader, Banharn Silpa-archa, meekly said he would support Mr Thaksin anyway.) Meanwhile, Banyat Bantadtan, the wooden leader of the Democrats, has said he will resign. That should pave the way for the younger, punchier and more photogenic

Abhisit Vejjajiva to lead the opposition.

Whoever is in charge, however, the opposition is unlikely to act as much of a brake on Mr Thaksin. They may not even be able to summon the 100 votes necessary to table (though not, of course, pass) a censure motion against a minister—the technique that won the Democrats attention in the old parliament. Thailand's media are cowed, the institutional oversight of government weak. Mr Thaksin's authority is virtually unfettered.

That need not mean big policy changes. Mr Thaksin has promised more populist schemes, of the type that have proved so pleasing to voters in places like Pai. The micro-credit schemes, for example, are to be upgraded to fully-fledged banks with an extra injection of government capital. Suranand Vejjajiva, a TRT spokesman, says Mr Thaksin also plans to complete some unfinished business from his first term, by pursuing education reform and further stimulating the economy. But he is unlikely to meddle much with the formula that has brought him such success.

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Afghanistan

Time for tea and ambushes

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And now nation-building

AMERICAN troops came to Afghanistan as vengeful warriors on the trail of al-Qaeda. But three years after the fall of the Taliban regime, the average GI is as likely to be rebuilding and making friends as hunting America's enemies. Fourteen garrisons, called Provincial Reconstruction Teams (PRTs), of American soldiers are distributing largesse across the country, often in still dangerous combat zones.

Soldiers are building hospitals and schools, digging wells, treating illness, training Afghan soldiers and police, and advising local officials. The teams are increasingly pleased with the public-relations success of their efforts. Friends are won, security improved, and Taliban remnants sidelined, their officers claim.

The PRTs are part of a new nation-building effort by the American government, from an administration that was once averse to the very idea. America doles out half of all foreign aid being spent on rebuilding the country, while the American ambassador meets its president daily to offer his assistance (and is nick-named the Viceroy for his pains).

At Gardez, a couple of hours' drive south of Kabul, is a showpiece PRT where American soldiers seem to have become almost a parallel administration. Special-forces teams still prowl the nearby badlands, raiding and ambushing suspects, and not long ago American troops were being attacked with rockets daily. But reservists from the PRT are transforming the scruffy town with a series of infrastructure projects, and supervising Afghan workmen at a big construction site for returning refugees. Other soldiers are training National Army units and setting up clinics.

Governor Asadullah Wafa, an advocate of reconciliation with the Taliban, is hugely enthusiastic about the American presence. He greets Major-General Craig Weston, a craggy American commander, as his dearest friend when the two meet for a chat over tea. Tribal worthies and American officers grin at each other across the language divide. Security is dealt with in a minute or two before the governor gets on to his shopping-list of requests—a new road, schools to be built, a hospital needed. Afterwards General Weston insists that the Afghans, not the Americans, are running the place. The soldiers are merely trying to jump-start reconstruction, he says. School-building in Gardez is a vital part of the war on terror.

Like other American officers in the south and east, the general complains that NGOs are not operating in the province even though it is secure. The NGOs, however, beg to differ. The PRTs have proved hugely controversial among Kabul's aid agencies. Paul Barker of CARE International has been a consistent critic. The army does development work poorly, he says; PRTs do not have the time or the training for it. Much of the work is later destroyed by Afghans who don't like foreign soldiers in their country, and anyway the main beneficiaries are militia commanders whom the soldiers want to recruit against the Taliban. The PRTs are also charged with blurring the

distinction between civilian and military in the eyes of Afghan tribesmen. Since March 2002, 35 NGO staff have been killed.

On balance, the PRTs have been a useful improvisation in difficult circumstances, fairly effective in improving security but less so at development work. Many critics grudgingly acknowledge that PRTs are better than nothing—which is what dangerous areas would otherwise have got. But it is hard to find anybody, even in the armed forces, who thinks that they can ever be more than trailblazers.

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India

A $50 billion bonanza

Feb 10th 2005 | BANGALORE
From The Economist print edition

The private sector is getting a bite at the defence budget

INDIA'S defence-procurement policy is an anachronism. Self-reliance has been one of the country's most consistent aims since independence. Yet its armed forces are heavily dependent on imports from Russia, Israel, Britain and France. This is because the public sector, which dominates domestic defence production, has never been able to meet the armed forces' needs. About 70% of the defence capital budget—$7.3 billion this year—is spent abroad. The Indian private sector has only a peripheral role, 14 years after India began opening up its economy. A plan introduced in 2002 to increase the private sector's role and let foreigners invest in it made little progress.

This may be about to change. A report now being finalised by a government committee headed by Vijay Kelkar, a former finance secretary, calls for much deeper reforms that could boost the role of the private sector, encourage co-operation with foreign suppliers, and turn India into a significant defence exporter. It currently sells only $130m abroad a year, but could capitalise on the skills and low employment costs that have made it significant internationally in software.

A handful of the most capable private-sector companies would be designated defence champions. They would probably include names such as Larsen & Toubro, Godrej, Mahindra & Mahindra, and Tata, which already produce parts ranging from a nuclear submarine's hull to software and bits of missiles. They could now compete on equal terms for full research, development and production projects with India's over-manned and often ill-managed public-sector defence corporations and with even less efficient ordnance factories and research outfits.

The ideas will be opposed by many parts of the defence establishment and by some foreign suppliers. The leftist parties on whose support the government depends won't like it either. But both foreign and Indian firms were competing to show off their wares this week at India's two-yearly air show in Bangalore, where the defence minister, Pranab Mukherjee, pledged his support for an increased role for the private sector. Boeing and Airbus said in Bangalore this week that they intended to buy more from India. With some $50 billion to spend on arms in the next five years, India has a bit of clout—and perhaps the will to use it.

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Myanmar

One last harvest

Feb 10th 2005 | WA SPECIAL REGION NO. 2
From The Economist print edition

A ban on opium will leave millions of farmers without livelihoods

BAO YOU XIANG looks nothing like a drug lord. His neatly combed hair and the well-ironed creases in his trousers do not suggest a man with his own rebel army numbering 20,000, and control over 400,000 opium farmers. For the moment, though, that is still exactly what he is. But it is a part he plans to stop playing in the next few months.

The supreme leader of Myanmar's Wa Special Region No. 2 will is allowing his farmers one last harvest—just getting under way—of opium poppies before enforcing an absolute ban on the drug, its cultivation, sale and consumption. After this year, he insists in an interview, "there will be no more poppies in this region. I once said that I would chop off my head if opium is still produced here after the ban. And I will keep my word."

The leafy poppy flower, *Papaver somniferum*, has grown for generations in this remote corner of the Golden Triangle, fuelling addiction on the other side of the world. For the farmers, opium is often the only way to earn a living. But for Mr Bao, and for Myanmar's beleaguered authorities, it is an embarrassment. Myanmar is the world's second-largest producer of opium, after Afghanistan, and powerful neighbours, like the Chinese, are fed up.

In Kaw Law Su village, every single family grows poppies to survive. With seven daughters, five sons and a handful of chickens to feed, Kya Law says he has no choice. Squatting on the rough deck of his stilted bamboo hut, he explains that poppy is by far the most profitable crop grown in the surrounding hills. In 2003 each household made an average of $250 dollars from opium—a pathetic sum, but still more than two-thirds of their annual income. Kya Law is painfully aware that the next opium harvest will be his last. He also knows he has no choice but to follow Mr Bao's orders. Wa rulers have a fierce reputation and a history of headhunting.

In 1995, Mr Bao committed himself to an opium ban during a meeting with the UN and the government in Yangon. If fully enforced, the ban will destroy one of the biggest components of the opium trade in the Golden Triangle, and shrink the world's supply of heroin.

Sceptics wonder. The output of opium in the Wa Special Region No. 2 may not have brought great prosperity to the people, but Chairman Bao has made a fortune through the production and trafficking of drugs. His United Wa State Army is built on drug money. His government openly collects a 7% tax on opium from farmers. And his own brother is accused of involvement in the production of methamphetamine pills, which are consumed in epidemic proportions in

neighbouring Thailand. Yet Mr Bao swears he is sincere. “Opium is not good for the people,” he says. “For years I have seen how opium is destroying the Wa. It makes my heart bleed. I will ban it to save my people.”

The UN seems to believe Mr Bao. Its Office on Drugs and Crime (UNODC) monitors opium production in the Wa region, and reports that he has already begun keeping his promise. Last year, the area under poppy cultivation (the best way of measuring output in remote areas, since satellites can be used, along with ground surveys) fell by 18% in Wa Special Region No. 2, where UNODC has provided some help to people trying to live without opium. In Myanmar as a whole, poppy cultivation fell by 18,000 hectares (47,400 acres) last year, or about 29%.

For the farmers, though, there will be big problems. In 2003, opium was banned in Kokang Special Region No. 1, just north of the Wa. Deprived of their main income, nearly one-third of the total population—an estimated 60,000 Kokang—left their homes in search of money and food. Health clinics closed down, school enrolment plummeted by 50%, and parents reportedly sent their daughters to brothels in Thailand and their sons to join rebel armies in a bid for survival.

“We certainly do not want to repeat this,” says the UNODC representative in Yangon, Jean-Luc Lemahieu. He says the Kokang's hardship is an indication that the struggle will be three times worse when the Wa and its 400,000 people enforce the opium ban this year. But caring for ex-opium farmers in the pariah state that Myanmar has become is not a popular cause on the international circuit.

“There is an impeding humanitarian crisis on hand here because of the cynical attitude of the West,” says Mr Lemahieu, who thinks that donors are well aware of the situation but won't put their money into the country because they fear criticism. By refusing to help the opium farmers, the world may loose a historic chance to tackle the drug trade, he says. Myanmar may repeat the history of Afghanistan, where opium production was put to a complete stop by the Taliban only to explode again after the fall of the regime.

In Kaw Law Su village the final harvest is moving closer. “I have nothing. I don't know what to do,” says Kya Law in the soft light from the evening sun. Two of his children are playing at his feet and a few of his neighbours are standing around his hut. He looks at them quietly. “We all worry and fear that we will suffer,” he says at last. “But we are villagers. If they say stop, we just have to stop.”

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Israel and Palestine

Peace in our time?

Feb 10th 2005 | SHARM EL-SHEIKH
From The Economist print edition

Israeli-Palestinian relations are entering the new post-Arafat era, with each side suspecting the other of cheating

Get article background

TWO of the most important players at this week's four-way summit in the Egyptian resort of Sharm el-Sheikh were notable chiefly for not being there. One was the man who had made it all possible. Yasser Arafat, whom Israel and America had declared interlocutor non gratis, was absent not only in body: after over 40 years at the helm of Palestinian history, he was relegated to a mere footnote in it. Only Mahmoud Abbas noted, as briefly as possible, that his election last month as president of the Palestinian Authority (PA) had been prompted by Arafat's death.

Also absent were Palestinian militant groups. Yet the summit's grand promises will in large part depend on them. Prodded by the visit of Condoleezza Rice, America's secretary of state, both Mr Abbas (aka Abu Mazen) and Israel's prime minister, Ariel Sharon, soulfully pledged to “stop all violence against all Israelis and Palestinians everywhere”. From Mr Abbas, this amounts to declaring an end to the *intifada* (uprising), which after four years has claimed over 3,000 Palestinian and 1,000-plus Israeli lives.

But whereas Israeli soldiers will largely do what Mr Sharon tells them, Mr Abbas's words—as a Hamas spokesman pointedly remarked the day after the summit—do not bind the militants, whether from Islamist groups like Hamas or Mr Abbas's own Fatah party. They are not yet ready even to discuss a *hudna*, or truce, like the one they declared after the last Sharon-Abbas summit in June 2003. Israel wants Mr Abbas eventually to disarm them, but it will be a long time, if ever,

before the Palestinian security forces are able and willing to launch a serious crackdown. Later in the week, Hamas fired a salvo of rockets at Israeli settlements in Gaza.

Keeping alive the ceasefire that has held shakily for nearly a month will require a series of baby steps forward. Mr Abbas, who had almost no political support of his own before Arafat's death, will have to build up his and the security forces' credibility with Palestinians. Promised reforms to make the PA more democratic and accountable will help.

Israel, meanwhile, has offered concessions. Halting military activity, as Mr Sharon promised, will include ending targeted assassinations of militants. Soon the army will start pulling out of five West Bank towns—though it promises to charge back in if it feels the need. Roadblocks will be lifted; 1,500 Gazans will get border-crossing permits. And the summiteers agreed on a joint commission to study future releases of the over 7,000 Palestinian prisoners in Israeli jails.

This last issue is particularly touchy. The PA met Israel's recent offer to release 900 prisoners with scorn, since most are in for minor offences or are due out soon anyway. What matters, says Khaleda Jarrar, who runs a prisoner-support group in Ramallah, is less the number of prisoners released than the kinds, such as those who are very young, or old, or ill, or were jailed before the Oslo accords of 1993, and whose release would be a genuine concession. Israel has refused to free people with “blood on their hands”—a broad criterion, says an official, which includes any Palestinian who indirectly took part in an attack in which Israelis were killed or wounded.

The Israeli government is split on both this and other issues, and the hardline camp, led by Avi Dichter, the head of the Shin Bet (the domestic security service), has lost some recent debates. A trickle of new releases could keep things inching forward. Mr Sharon now says that even bloody-handed prisoners may be freed, if the Gaza pullout goes well.

All this should, for a while, maintain the feel-good factor of Sharm el-Sheikh. So will Mr Sharon's jovial offers to have Mr Abbas over to his desert ranch and to visit him in Ramallah—offers he could never have made to Arafat. But a single trigger-happy Palestinian militant or Israeli soldier or settler could blow the ceasefire apart. Much will depend on how well the two sides co-operate if (and probably when) that happens.

Palestinians remain unhappy that the summit dealt with Israel's security, yet Israel made no promises to stop building the settlements and the barrier with which it is tightening its grasp on the West Bank. Mr Sharon, like Mr Abbas, talked of reviving the international “road map” plan for peace, which posits a construction freeze in its first stage. He will need to give signs fairly soon that he means it. If not, Palestinians may conclude that the ceasefire is designed to benefit Israel more than it benefits them, and that they have little to lose—apart from America's good opinion of Mr Abbas—by breaking it.

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Iraq's election

Sectarian riddles

Feb 10th 2005 | BAGHDAD
From The Economist print edition

The Shia clergy must be careful not to assert themselves too aggressively

WITH the full result of Iraq's election still not known, it is pretty clear that the United Iraqi Alliance, the Islamist-inclined and clergy-backed coalition of Shia-led parties which claims Grand Ayatollah Ali al-Sistani as its chief mentor, has won with a landslide, perhaps even taking over half the National Assembly's 275 seats. In Iraq's southern half, the alliance may have won as much as three-quarters of the vote, though that figure will dip, as a proportion of the national total, when full results from mixed cities such as Baghdad and from the Kurdish north come in.

If the “Shia house” or “clerics list”, as the alliance is widely known, does get an outright majority, it will still have to co-operate with others, since a new government and prime minister need the endorsement of two-thirds of the assembly's members. Moreover, the alliance is split. Three of its leaders—Dr Ibrahim al-Jaafari of the Dawa party, Adel Abd al-Mahdi of the more Islamist-minded Supreme Council for Islamic Revolution in Iraq, and Ahmed Chalabi of the Iraqi National Conference have all proposed themselves as prime minister, while one of the Kurds' two main leaders, Jalal Talabani, has his eye on a top job too: president, prime minister or parliament's speaker. Moreover, all the leading parties accept that a Sunni Arab should have one of those plums.

This does not leave much room for the current interim prime minister, Iyad Allawi, a secular-minded Shia who headed his own list, which is expected to come third after the Kurds. But he may still have a chance of keeping his job as a compromise figure with ties to some Sunni leaders and former army officers; for those reasons, it is widely thought he may be best qualified to rebuild Iraq's security forces.

During the election campaign, the Shia alliance stressed that it would not impose an Islamist agenda and would respect the rights of Sunnis and non-Muslims. Its list, it emphasised, included many non-Shias and secularists. Islam would merely be the official religion, and no laws would be allowed to flout Islam's “universally agreed tenets”. The alliance's softer language reassured even the secular-leaning Kurds, who have been worried that the Shia clergy would try to impose their conservative southern ways on the more liberal north.

That is why secular-leaning Iraqis were rattled this week when Grand Ayatollah Muhammad Ishaq al-Fayed stated that Islam must be “the sole source” of law and that religion and the state must

be as one. Various prominent Shias then struggled to distance themselves from Mr Fayed's words without actually repudiating them. “What would you expect a cleric to say?'' asked Dr Jaafari. A spokesman in the office of Mr Sistani, first among equals of Iraq's four grand ayatollahs, insisted that he would not seek to impose Islamic law.

Still, many secular-minded Iraqis are worried that the ayatollahs had been floating a trial balloon and still want to impose a conservative, religion-influenced legal code, if not a theocracy. Mr Sistani's view of social mores is certainly conservative. His website, for example, says beards are obligatory, chess is “absolutely unlawful”, and romantic chit-chat between young men and women, even by telephone, is forbidden until they are engaged.

But his admirers seem ambivalent over whether his spiritual advice should necessarily be turned into law. Some say that “ultra-western” ideas and habits, such as allowing women in the police or tolerating premarital sex, should be banned, but that the law should be based on a civil code influenced by Islam but not taken directly from *sharia*. Others say the clergy should lay down the law on marriage and divorce but leave most of the rest alone.

The clerics' views on Islam and the state are entwined with the issue of federalism. Many secular Kurds say they do not care what is banned in the Shias' holy city of Najaf, provided that no one stops them from sipping whisky and holding mixed-sex picnics in their hills up north. Some secular-minded Baghdadis, however, fret over the possibility of a Kurdish “sell-out”, whereby the Kurds agree to let Shia conservatives impose their social mores in the centre and south, in exchange for the Shias agreeing to let the Kurds keep the bitterly disputed, ethnically mixed city of Kirkuk within a highly autonomous Kurdistan. So the unity of Iraq depends to quite an extent on how forcefully—and widely—the clerics assert their social agenda.

So far it looks likely that the insurgency-ravaged Sunni Arab provinces, where the voter turnout was low, will be badly under-represented. All the same, the strong turnout in the rest of the country, which probably added up to nearly 60% of eligible voters, was a big blow to the insurgents. Nonetheless, they have been fighting back furiously, with suicide bombs among other means, since polling day: no sign at all of them letting up.

The Muslim Scholars' Board, a gathering of Sunni clerics which has praised the insurgency, now says the rebels should stop fighting if a new government can set a timetable for an American troop withdrawal. This does not yet mean much, as President Bush says his forces will leave only when the country is secure under a new order or if Iraq's government asks them to go. But since the election the Sunni clerics' tone has been more conciliatory. Some Sunni parties who boycotted the poll say they want to help draft a constitution—a central task of the new assembly.

But such progress could be undone if the Shia clergy promote their agenda too aggressively. Many conservative Sunnis also want Islam to be the source of law but would differ with the Shias over many details. If the Shias now make laws that appear to derive from a purely Shia interpretation of Islam, the insurgents may stir up Sunni sectarian sentiment, even as the nationalist argument for fighting fades.

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Saudi Arabia

Shifting sands

Feb 10th 2005 | RIYADH
From The Economist print edition

The first shoots of controlled democracy are visible but still tiny

Get article background

EPA

Beady eyes on the candidates

SOMETHING looks different about the Saudi capital. Perhaps it is the presence of random checkpoints and armed guards, a response to a two-year wave of terror attacks. Or maybe it is the sight of giant billboards featuring the faces of aspiring politicians. The election ads are especially unusual, and not only as an exuberant first inkling of democratisation in this absolute autocracy. Before last month, the country's religious police would have considered such publicly displayed images of the human face to be unIslamic “idols” that should be blotted out. They could be right: one candidate reports that a lady who liked his picture has been pestering him to take her on as a second wife.

Whatever the case, change is certainly in the air in Riyadh, a city of walls and veils. To many Saudis, it is change for the better, after a long drought. Take this week's elections. Like many Saudi reforms, it is easy to dismiss them as shallow. They are for only half the seats on town councils. Half the potential electorate—women—are not invited. Only a third of eligible men have registered to vote in the capital. So it is a sort of democracy—with king-sized training wheels.

Yet the Saudi public, sceptical at first, appears increasingly enthusiastic. Nearly 700 candidates are competing for just seven open seats in Riyadh, where the first of a series of staggered elections is taking place, through until late-April. The campaigns have quickly taken on a uniquely Saudi style. Many candidates have pitched bedouin-style tents; places to show hospitality, inform constituents, and entertain them with everything from rousing sermons by famous preachers to stockmarket tips. Others have gone high tech, posting websites and blitzing the city's mobile phones with text messages. The costliest campaigns are said to have swallowed upwards of a million dollars.

While most candidates promise traditional things, such as better rubbish collection and safer streets, others represent deeper political trends. One text message making the rounds suggests that the truly pious ought to vote for certain candidates. Liberals are fighting back, with one contestant, for instance, running on a platform of demanding the right for women to drive cars and, of course, to vote.

“What gives me most satisfaction”, says Prince Mansour bin Mitaab, a professor with the job of organising the polls, “is that we now have Saudis in every town and province who know how to manage an election.” The kingdom now has a system and a precedent for practising democracy.

The political spectacle is not the only thing boosting Saudi morale. Since the first big bombing in May 2003, more than 200 people have lost their lives to terrorism inside the kingdom. As recently as December, al-Qaeda cells attacked the American consulate in Jeddah. Yet the consensus now is that the government has gained the upper hand. The much-reduced western expatriate community is still fearful. But the slow-moving Saudi government has at last mobilised a massive and apparently effective campaign to stem the scourge.

Stringent security, including the arrest or killing of some 400-500 suspects, is only part of this. Other aspects include strict financial controls on Islamic charities, a ceaseless barrage of anti-extremist propaganda, and stark warnings to preachers to tone down the vitriol.

The Saudis have another reason to feel more confident. They are flush with cash. Three years ago the economy staggered under low oil prices, soaring joblessness and domestic debt. The past two years have steered it past such shoals. “Last year was simply the best in Saudi history,” says Brad Bourland, the top economist at SAMBA, a big Saudi bank. Stock prices surged 86%. Oil exports rose by $30 billion.

Of course, all is not entirely well. The country's social and political mores remain stifling, especially for women. The official, Wahhabist religious establishment condemns terrorists not on the grounds that their hatred for infidels is wrong but because they have disobeyed their “rightful commanders” who grant those infidels protection inside the kingdom. Dissidents risk being jailed, fired from their jobs, or banned from travel. Reform is much discussed, it is true, and piecemeal action is taken. But as a long-time foreign resident remarks, “They talk the talk, but they walk the walk with an arthritic shuffle.”

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The UN's oil-for-food scandal

Something rotten

Feb 10th 2005
From The Economist print edition

Paul Volcker points fingers but more muck-raking will follow

Get article background

IT WAS neither a whitewash nor did it reveal a smoking gun. The report of the independent committee of inquiry into the UN's $70 billion oil-for-food programme, published on February 3rd, was what Paul Volcker, its chairman, had said it would be: a hard-hitting but limited interim report focusing on the role of the UN's secretariat. The full story of the world body's biggest-ever scandal, including the role of its Security Council, must await the committee's final report, due this summer.

Critics of the UN, who have been baying for blood, will be disappointed by the 240-page report's failure to examine the performance of Kofi Annan, the UN's secretary-general. The committee is to leave to a second interim report the allegations surrounding the involvement of his son, Kojo, with Cotecna, a Swiss company hired to monitor humanitarian imports into Iraq under the UN's scheme.

But Benon Sevan, a Cypriot who headed the UN office that ran it, is accused of repeatedly soliciting oil allocations on behalf of African Middle East Petroleum (AMEP), a trading company run by an Egyptian friend. This was “a grave and continuing conflict of interest...[that] seriously undermined the integrity of the UN”. In return, Mr Sevan was expected to “act favourably” toward the Iraqi regime. To what extent he did so is unclear. Though he argued for Iraq's right to use part of its oil proceeds to buy spare parts for its oil infrastructure, this was not necessarily reprehensible. Indeed, in June 1998, the Security Council authorised $300m of oil-revenue money for just this purpose.

But the report suggests Mr Sevan may have benefited personally. Thanks to his intervention, AMEP made a neat $1.5m from the affair. He himself received cash payments totalling $160,000 between 1999 and 2003, which he claims came from an elderly aunt, now dead. But she was a retired Cyprus government photographer living on a modest pension in a small flat.

The committee is now anxious to delve deeper into the links between Mr Sevan, Fakhri Abdelnour, AMEP's Egyptian owner, Fred Nadler, who acted as a go-between, and Boutros Boutros-Ghali, a former UN secretary-general, under whom the oil-for-food scheme was set up. Mr Abdelnour is Mr Boutros-Ghali's cousin, Mr Nadler his brother-in-law. The report also castigates UN officials, including Mr Boutros-Ghali, for violating financial regulations and bypassing the UN's normal competitive bidding process in selecting the three main contractors for the oil-for-food programme. But there was no suggestion of corruption here.

Mr Annan has announced the suspension of both Mr Sevan, who has denied any wrongdoing, and Joseph Stephanides, a former head of the UN's sanctions branch, pending disciplinary

proceedings. Both could face dismissal, as well as eventual criminal proceedings.

Various estimates, all of them American, have been made as to how much Saddam Hussein managed to glean from the oil-for-food programme. These range from $10 billion to $21 billion. The committee has not yet aired its own figure. But it points out that Mr Hussein's main source of illicit revenue was from sanctions violations outside the programme, including smuggling oil via Turkey and Jordan, two key American allies. Much of this was known about and even condoned by Security Council members. Mr Volcker's committee reckons that kickbacks and surcharges on the UN's oil-for-food scheme were worth less than $2 billion.

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Togo

Eyadéma's woeful legacy

Feb 10th 2005 | LOMÉ
From The Economist print edition

Africa's most experienced despot is dead. Will Togo hold together?

AFP

Eyadéma after only seven years in power

HE DIED as he would have wished it, without surrendering a scrap of power. Gnassingbé Eyadéma, Africa's longest-serving ruler, succumbed to a heart attack on February 5th, while en route for medical treatment in France. He seized the presidency of Togo in a coup in 1967, some 20 years before the average Togolese was born. His loyal army honoured his memory by mounting another coup, within hours of his death, to place his son, Faure Gnassingbé, on the throne.

Mr Eyadéma was not the worst of Africa's despots. He was less murderous than many of his contemporaries, though Amnesty International complained that torture was rife in his jails. Per head, Togo is 12% poorer than when he seized power, which is an awful record, but better than some. His admirers pointed out that he kept Togo stable, up to a point.

A champion wrestler and former sergeant in the French army, Mr Eyadéma rose to prominence in 1963, when he took part in Togo's first successful coup. Accounts differ as to whether he fired the shot that killed the president, Sylvanus Olympio. Four years later, he led a coup of his own, and banned all opposition.

He survived several coup plots and assassination attempts, the more dramatic of which he liked to re-enact for visiting foreigners. He kept one would-be assassin's bullet as a memento. His toadies said he was protected by God. A more plausible explanation for his longevity was that he was on good terms with every French president from Charles de Gaulle to Jacques Chirac, and he reserved the top jobs in the Togolese army for his ethnic kin from the north of the country.

It was perhaps fear for their careers that prompted the top brass to ignore the constitution, which called for the speaker of parliament to be made interim president pending elections in 60 days, and elevate Mr Eyadéma's son instead. The speaker, who was abroad when Mr Eyadéma died, wisely stayed there. Togo's parliament quickly amended the constitution to legalise the putsch, retrospectively.

Opposition groups denounced the coup and called for a general strike with the slogan “Togo, a dead country”. Thousands stayed at home, but by the afternoon of February 8th, most of those with jobs had gone back to them. The government, meanwhile, declared a two-month mourning period for the late despot, during which street protests were banned.

Togo's neighbours are alarmed. Nigeria's president, Olusegun Obasanjo, said the coup should not stand. At an emergency summit in Niger on February 9th, west African leaders vowed not to recognise the new government. The African Union threatened sanctions, though this may mean no more than that Togo is barred from its meetings. European donors, who had suspended most aid to Togo in 1993 but were talking about resuming it, said that was now out of the question.

The mood in Lomé, the coastal capital, is gloomy. The country is “a mess”, says Emmanuel, an unemployed graduate. Mr Eyadéma so dominated politics that Togo has developed no reliable mechanisms for resolving disputes without him. He always took a dim view of democrats, accusing them of fomenting disorder and even of being behind the scourge of elephant-poaching in his home region of Kabyé. It was only under intense pressure, principally from France, that he allowed semi-competitive elections in 1998 and 2003, which he won through a mixture of rigging and intimidation.

With Mr Eyadéma gone, some worry that Togo could go the way of Côte d'Ivoire, which has stumbled into civil war since its long-serving strongman, Félix Houphouët-Boigny, died in 1993. People from the south of Togo are restive after four decades of marginalisation. Faure Gnassingbé tried to calm them by promising “free and transparent” elections soon. But he did not name a date.

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Corruption in Kenya

Feet of Clay

Feb 10th 2005 | NAIROBI
From The Economist print edition

More bad news for honest Kenyans

LAST year, Britain's envoy to Kenya complained that corrupt ministers were “eating like gluttons” and “vomiting on the shoes” of foreign donors. This week, he apologised. Sir Edward Clay said he was sorry for “the moderation” of his language, for underestimating the scale of the looting and for failing to speak out earlier. Kenya's government retorted that Sir Edward was “an incorrigible liar” and an enemy of Kenya.

But others appear to share the tactless diplomat's views. Five other western ambassadors echoed them. And John Githongo, the Kenyan civil servant charged with rooting out corruption, resigned this week and has gone into exile, apparently fearing for his life. Mr Githongo, who used to write for *The Economist*, was regarded as one of a finite number of honest men in the administration of President Mwai Kibaki.

Mr Githongo had for some time been frustrated at the government's unwillingness to let him grapple with a number of scandals. His departure dents the government's credibility. The United States promptly suspended an aid package worth $2.5m for anti-corruption efforts in Kenya. Larger amounts are imperilled, as donors grow tired of seeing so much of their money wasted.

Mr Kibaki was elected two years ago after promising to tackle the graft that thrived under his predecessor, Daniel arap Moi. He made a promising start, purging the judiciary and curbing the police's habit of shaking down motorists for beer money. But he has grown frailer in office, and now cannot seem to find the energy to keep up his crusade. Cabinet colleagues report that he sleeps 12 hours a night and has a nap after lunch.

Sir Edward says he has handed over a dossier detailing 20 corruption scandals involving ministers. The missing money, according to William Bellamy, the American ambassador in Nairobi, could fund anti-retroviral treatment for every HIV-positive Kenyan for ten years.

Mr Kibaki's attorney-general sought to restore confidence in the government by announcing the creation of a new “Corruption Prosecution Unit” on February 9th. But it remains to be seen whether it will have teeth.

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Spain and the Basques

Independence days

Feb 10th 2005 | MADRID
From The Economist print edition

Getty

The Spanish government faces a delicate negotiation if it is to forestall Basque demands for some form of independence

Get article background

ANOTHER week, another ETA outrage. On February 9th the Basque terrorists exploded a car bomb in Madrid, injuring over 40 people outside a convention centre about to be visited by the king and the Mexican president. This is the latest in a string of car bombings, though nobody has been killed by ETA for over a year.

The bombs come at a sensitive point in Madrid's relations with the Basques. Mariano Rajoy, leader of the opposition People's Party (PP), has accused the Basques of making a “thinly veiled declaration of independence”. He is referring to the plan of the Basque premier, Juan José Ibarretxe, to hold a referendum on the region's right to self-determination and to form a “free state associated with Spain”. The Socialist government of José Luis Rodríguez Zapatero is also under pressure from Catalans who want far more autonomy, especially Josep Lluís Carod-Rovira, leader of the Catalan Nationalist Left that shares power with the Socialists in Catalonia.

Mr Zapatero is accused by critics both of being soft on terrorism and of presiding over the disintegration of Spain. His PP predecessor, José María Aznar, refused to speak to Mr Ibarretxe. Mr Zapatero's conciliatory tone has been seen as weakness. Some claim that regional ambitions pose the greatest threat to Spanish unity since the civil war. Will there soon be an independent Basque state? If Catalonia takes the same path, is this the end of Spain?

The short answer to both questions is no. But there are bumpy months ahead for Mr Zapatero, as Spain's two most fractious regions engage in rough horse-trading over their future relationship with Madrid.

The Spanish government insists the Ibarretxe referendum will not be allowed. “It is simply not going to happen. All the exits are locked,” the justice minister, Juan Fernando López Aguilar, told *The Economist* this week. Why not? “It is unconstitutional. It is a matter of principle,” he replied. One poll suggests that over 60% of Spaniards want the government to take legal action against the Basque government if it tries to hold the referendum and—incredibly—over half think the armed forces should be wheeled in to stop it.

Mr Zapatero's troubles began in late December when the Basque assembly voted for the Ibarretxe plan, which seeks to introduce Basque citizenship, an independent judiciary, a penal system, devolved responsibility for social security and the power to sign international treaties. It also stakes claims to Navarre and the French Basque region.

In mid-January Batasuna, ETA's banned political wing, said it was prepared to work for “an agreement between nationalists and non-nationalists”. The party leader, Arnaldo Otegi, drew a parallel with Northern Ireland, and called on Mr Zapatero to “go down in history as the Spanish Tony Blair” by negotiating a peace deal. Two days later ETA, which despite its bombings has been weakened by recent arrests, announced its support for Batasuna's overtures. But Mr Zapatero has said that he will talk to ETA only once it lays down its arms indefinitely.

Earlier this month Mr Zapatero allowed the Ibarretxe plan to be debated in the Spanish parliament, the Cortes. “I have come to this parliament to defend the right of the Basque people to decide their own future,” said Mr Ibarretxe. After eight hours of debate, the plan was overwhelmingly rejected, by 313 votes to 29. Mr Ibarretxe responded by vowing to call his referendum anyway and moving regional elections forward to April 17th. “The moment has come for Basque society to speak out,” he said. “No one who calls himself a democrat can deny our right to decide for ourselves. We can only co-exist with Spain by our own free will.”

The polls suggest that Mr Ibarretxe's Basque Nationalist Party (PNV) and its allies will win 42% of the vote, falling three seats short of an absolute majority. The PNV has asked Mr Zapatero to allow Batasuna to run in the elections, but refused to delay to give it time to declare the necessary ceasefire. At the May 2001 election seven Batasuna politicians won seats that they kept even after the party was later banned. Theoretically the party will now disappear from any official position.

Mr Zapatero did, however, tell the Cortes that its debate had opened the way for negotiations to take place “for a new project for Euskadi [the Spanish Basque region] and Spain”. He added that “the highest degree of self-government is possible, but we will decide together. All the Basques will decide—and all Spaniards.” Previously he had ruled out a parliamentary commission to renegotiate the Basques' status. Now it is a possibility.

Hours before the debate the Basque Socialist leader, Patxi López, proposed a diluted form of the Ibarretxe plan that skated around sovereignty. News also emerged of a secret meeting between Mr Zapatero and the PNV president, Josu Jon Imaz. PP tongues have been wagging about a possible deal: Madrid might, for instance, accept more devolved tax-raising powers and a fully autonomous education system.

For all the PP's carping, Mr Zapatero could yet emerge as the architect of a “new Spain”. The constitution has served 27 years; Catalan nationalists are drawing up a new one which, despite Mr Carod-Rovira's populist harangues, will, according to Catalonia's Socialist premier, Pasqual Maragall, remain within the bounds set by the 1978 text. The Basques may yet be persuaded to stay within those bounds too.

France's 35-hour week

Hollow protests

Feb 10th 2005 | PARIS
From The Economist print edition

Is it really dying?

"IT'S the end of the 35-hour week," deplored an official from the CGT, France's biggest trade union. The reform "will be the death of the 35-hour law", *Le Monde* opined. Has the change to France's working-time law, which parliament passed on February 9th, scrapped the 35-hour week? To judge by all the protests, it might seem so: some 300,000-500,000 demonstrators took to the streets of France last weekend in a bid to protect the 35-hour week from such a "fatal blow".

Yet the stand-off is deceptive; as one official says, it "has more to do with politics than with economics". Last summer, when demands for a reform to the 35-hour week began to stir, President Jacques Chirac made clear that "the legal working time is, and will remain, 35 hours." The latest amendment explicitly states that there is no change to the legal working week. But it makes it easier for employees to choose to spend more time at work: they can, for instance, cash in extra days off and work instead, or work longer hours if a collective agreement is reached with their company.

As Jean-Pierre Raffarin, the centre-right prime minister, puts it, the point is to enable "those who want to work more to earn more". When the 35-hour week was introduced by the former Socialist government, employees got to work four hours less each week with no loss of pay. But most then suffered a pay freeze in return. With more time on their hands, but less money in their pockets, employees thanked the Socialists by booting them out in 2002. Mr Raffarin's changes are partly meant to restore lost purchasing power. This fits with broader plans just unveiled by Hervé Gaymard, the finance minister, to cut income tax and boost consumption.

Yet the new measures are voluntary: both employer and employee must agree. An employer cannot impose extra hours, which will anyway be subject to 125% overtime pay. Nor will employees be guaranteed the extra hours they may seek. With the economy likely to grow by only 2.5% this year, the problem is thin order-books, not a need for overtime. The public sector is excluded from the new rules. And Mr Raffarin's changes will not protect small companies forever: in 2008, firms employing fewer than 20 people will have to pay 125% for overtime, not 110% as now.

Many big companies that painfully negotiated a shorter working week in 2000-02 are no longer keen to re-open it. Not that the policy was cost-free. Rather, they extracted flexible working practices and a pay freeze in return for the shorter week, and so learned to live with it. But mid-sized firms and the service sector had more problems. In return for not working a 35-hour week, many middle-ranking office workers won 10-20 extra paid days off, creating a management headache. Absenteeism has risen, according to a parliamentary report, as regular absence has been legitimised. In many ways, it is office staff not factory workers who benefited most from the 35-hour week. Nor is there any evidence that it created new jobs. It was implemented at a time of buoyant growth. Unemployment now touches 10%.

So why the fuss over the latest reform? The answer lies in the political struggle between the ruling centre-right and the Socialist Party, for whom the 35-hour week was its emblematic achievement. Mr Raffarin came round to reform only when it became clear that his party was itching to deal a symbolic blow to the left. Elections are still two years off, but the left is ahead in the polls. François Hollande, the Socialist leader, was among the protesters at the weekend. Of the rest, most were public-sector workers, who are unaffected by the reforms. Many were campaigning for a pay rise. Others were protesting against the European Union constitution.

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France and America

Condi's charm offensive

Feb 10th 2005 | PARIS
From The Economist print edition

Dreams of Franco-American rapprochement may be just that

Reuters

An American in Paris

IT HAS been a good week for symbolism. Condoleezza Rice, America's secretary of state, dropped in to deliver a "landmark" European speech in Paris, chosen because of the intensity of past Franco-American disagreement. Then Donald Rumsfeld, the American defence secretary, arrived in Nice for an informal NATO defence ministers' meeting, the first that France has hosted since de Gaulle pulled out of NATO's integrated military command in 1966. As political theatre, the message of mutual seduction could not have been clearer.

For Ms Rice's visit, the atmospherics were faultless. Michel Barnier, the foreign minister, called her "Condi" and she smiled back "Michel". Speaking in a student hall on the left bank, the heart of anti-American intellectualism, Ms Rice talked of a "new chapter" in Franco-American relations and of a need "to turn away from the disagreements of the past". She stressed America's commitment to resolve the Arab-Israeli conflict. She even said that "America has everything to gain from having a stronger Europe". It was a world away from George Bush's sniping at "countries like France" in his election campaign.

Yet behind the tender words, big differences remain. Ms Rice stressed matters on which the French and Americans are co-operating—Kosovo, Afghanistan, Lebanon and Syria—but she ducked the issue of the EU plan to lift its arms embargo on China. Nor did she persuade her interlocutors that she had a clear strategy on Iran. On Iraq too, she side-stepped sensitive topics, including disappointment at France's military contribution. The French have offered to train 1,500 soldiers, but only outside Iraq.

Moreover, Ms Rice's expressions of support were conditional. America backed "a stronger Europe", she said, but "as a partner" engaged in "a common effort"—a knock at President Jacques Chirac's repeated calls for a "multipolar world". Her comments welcoming "the growing unity" of Europe carried a sting for the French, for whom the price of the spat over Iraq was a divided Europe.

"It's not really a rapprochement," says François Heisbourg, of the Foundation for Strategic Research. "We've both decided it's not in our interests to be at each other's throats. But that does not mean we now have a common purpose." A German Marshall Fund poll last month duly showed that, while 47% of Americans approved of Mr Bush's handling of international affairs, only 11% of the French did; fully 88% disapproved.

Catholics and Muslims

Awkward partners

Feb 10th 2005 | ROME
From The Economist print edition

An often vexed relationship

AP

Jaded by privilege?

Get article background

ONE of the last statements by Pope John Paul before he went into hospital on February 1st was an apparently banal but in fact pointed remark about the European Union. The EU, he said, “remains willing to welcome other states, who are ready to accept the requirements for admission.” In Vatican-speak, this was more than a tautology; it referred to Turkey, due to start talking entry terms in October. The pope was overruling Cardinal Joseph Ratzinger, his German aide, who said last August that Turkey should seek partners elsewhere because its Muslim faith was “in permanent contrast” with Europe's Christian legacy. But the pontiff was also saying that entry had a price: religious liberty in Turkey.

Similar arguments over the terms for a happy co-existence are being faced by many of Europe's churches as they consider Islam's fast-rising profile in a continent where most people, albeit loosely and lazily, call themselves Christian. Cardinal Ratzinger's sharp words were in line with a nervousness about Islam watering down Europe's “Christian heritage” that has become palpable among Teutonic churchgoers, especially after last November's murder by an Islamic radical of Theo van Gogh, a Dutch film-maker.

As the pope hinted, the climate in Europe may also be affected by events in other places where the two religions meet. Father Justo Lacunza Balda, a Vatican expert on Islam, predicts a “challenging” time ahead for Christian-Muslim relations in Europe and beyond. In its stance towards Islam, Vatican diplomacy has tried to defend Christians where they are at risk from conflicts, such as in Nigeria and Sudan. It has also distanced itself from American foreign policy, in

the hope of shielding Christians in places like Iraq.

Mr Lacunza Balda says Europe's Christians should protect Muslims from discrimination—but that European Muslims should also speak out for Christians in Islamic countries. Some of the plainest expressions of concern about Christian-Muslim relations have come from clerics with an active interest in dialogue with Islam. In Lyons, for example, a left-wing Catholic priest, Father Christian Delorme, has spent two decades talking theology with Muslims and backing their demands for a better economic deal. Recently he spoke out against “neo-fundamentalism” in French Islam—and was denounced on Muslim websites as an interfering paternalist. Meanwhile Cardinal Jean-Marie Lustiger, archbishop of Paris, defended France's secular regime against proposals to change it to accommodate Muslims. There is a risk, the cardinal said, of Islam becoming a “state religion” by the backdoor.

Keith Clements, secretary of the Geneva-based Conference of European Churches, which groups over 100 Protestant and Orthodox religious groups, says his members must gear up for a sometimes difficult dialogue with Muslims of all stripes, from moderates to militants. “There is always a temptation to choose partners with whom you already agree—but we mustn't ignore the others, or say polarisation doesn't exist,” he says.

Existential angst is nothing new for Europe's Christians. They have often fretted over when to shrug their shoulders, and when to take a stand, as societies grow more secular, more liberal in sexual and social behaviour and less interested in going to church. In most European countries, except secular France, Christian churches have inherited a privileged link with the state. Most Danes and Norwegians belong to their state churches; Germans, Swedes and Finns are encouraged to pay taxes to a church of their choice. In Catholic countries such as Ireland and Poland, church and nation are linked in the minds of many. Such legacies are not just hangovers, says Grace Davie, a British sociologist. They reflect the fact that many Europeans want a Christian church available—at times of grief or celebration—even if they rarely darken its doors.

Europe's churches have long been wondering if they should rest on these ancient privileges, or if instead active Christians should become a small, more effective minority that can make its voice heard on issues it cares about. Now, the rapid rise of European Islam is sharpening their dilemma. Will Christians and Muslims lobby together in causes ranging from “social justice” to moral conservatism? Or will they be competing for a privileged place in the public arena? Some have suggested, for example, that to curb Islamist militancy European states should train Muslim clerics and reduce the influence of foreign-trained firebrands. But such talk sounds explosive to French citizens who want to keep state and religion apart. It also upsets those who think that, if there is any “state religion”, it must be Christian.

This reflects a big difference between the two faiths. For quite a few Christian churches, ties to the state are a vital crutch, without which they would be jaded and weak. On the other hand, in many Muslim countries state oversight is seen as desirable for the opposite reason: to restrain, or at least channel, the zeal of a fervently religious public. This difference may only aggravate tensions between a religion that in Europe is small but growing and one that is big but declining.

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Dresden 60 years on

Misusing the memory

Feb 10th 2005 | DRESDEN
From The Economist print edition

Responses to neo-Nazis' exploitation of the Dresden anniversary

TOURISTS in Dresden this weekend risk landing in the middle of rival protests. To mark the 60th anniversary of the city's destruction by allied bombers on February 13th, some 3,000 neo-Nazis from across Europe are staging a “funeral march” starting at the restored Semper Opera House. Hundreds of anti-fascists will take to the streets to protest against the neo-Nazis. All this may overshadow attempts by local leaders to develop a new approach to commemoration that could yet beat back the neo-Nazis.

The story of what happened 60 years ago is unchanged, despite research showing it to be wrong. Dresden is seen by many “as a unique and innocent city, which experienced, without warning, a needless and singular act of destruction,” writes Matthias Neutzner, co-author of a new book, “The Red Glow”. The reason, says Mr Neutzner, is that this picture has been so useful. Nazi propaganda created it in the closing months of the war. In the cold war, East German communists turned Dresden into a symbol of American imperialism. Since then it has revived with once-taboo tales of German suffering, such as “The Fire” by Jörg Friedrich.

Today, “Dresden” looms large in the bible of neo-Nazis, especially of the National Democratic Party (NPD). The NPD has made Saxony's capital its centre, sending its best people there. That may explain the party's success last September, when it got into the state parliament. In January, NPD deputies caused a stir over the anniversary by talking of “a Holocaust of bombs”.

Yet even as neo-Nazis have made their presence felt, civic leaders have written a new declaration which they call a “framework for commemoration”. “We are remembering”, it states, “the contributions of citizens and institutions in Dresden to war-mongering, National Socialist oppression and crimes committed—for example against the city's Jews.” Much of Dresden's elite has signed this declaration, and the city government is strongly behind it. It recently invited Frederick Taylor, a Briton, to speak about his new book, which argues that Dresden was not an innocent “Florence on the Elbe”, but a military and transport hub.

The official poster for the 60th anniversary features the names of a dozen “war cities”, including not just Dresden, but also Hiroshima, Baghdad and even New York (because of September 11th). The city has also asked a group of historians to calculate the true number of victims, a matter of much controversy, with estimates ranging from 25,000 to more than 200,000. But can any of this stop extremists misusing the memory? Mr Neutzner, who helped to write the declaration, is the first to admit that it will take time for Dresden to become a symbol of overcoming war, racism and violence. What it needs, he argues, is an institutional foundation, such as the “world centre for peace” that the Church of our Lady (Frauenkirche) is to become.

At least Dresden is ahead of the national debate. Germany's mainstream politicians have reacted to the NPD's rise by reconsidering a ban on the party, even though a first effort at one failed in

2003. They have yet to agree whether to hold a big anti-fascist rally at Berlin's Brandenburg Gate on May 8th, the 60th anniversary of the end of the war. Instead, they are finger-pointing: Edmund Stoiber, Bavaria's conservative premier, has blamed the government for the NPD's revival because it has done too little to cut unemployment. The implicit comparison is with Weimar before Hitler took power in 1933. So much for the solidarity of democrats.

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Tax in central Europe

Too high everywhere

Feb 10th 2005 | RIGA
From The Economist print edition

Tax levels in the new EU members are higher than some critics claim

IF SIMPLE extrapolation holds, then happy Slovaks may soon pay no taxes at all. As a share of GDP their tax burden fell by one-quarter, or almost ten percentage points, between 1995 and 2003, according to the 2003 figures just released by Eurostat, the European Union's statistics office. Slovakia vies with the Baltic states for the title of the EU's most lightly taxed country. Taxes took 30.9% of GDP in 2003, less even than in Estonia, but still a tad more than the 29.1% in Latvia and 28.7% in Lithuania.

The Baltics and Slovakia have been forced to adopt radical strategies for economic growth, because they are the poorest countries in the EU. They have chosen well. According to Eurostat, the Baltics were the fastest-growing EU countries last year, and they should repeat that achievement both this year and next, with Slovakia close behind.

The worry is that other new EU members have not been similarly bold in cutting taxes and public spending. Slovenia's tax burden in 2003, at 40.3% of GDP, was not far short of Germany's. And Germany's tax burden was going down, while Slovenia's was going up. Hungary's government soaked its citizens for 39.2% of GDP, a bigger tax burden than Britain's. The Polish and Czech governments taxed a little less, though Czech taxes have crept up from 34.6% of GDP in 2001 to 36.2% in 2003.

If nothing else, these figures give the lie to claims by France and Germany that the EU's new members are irresponsibly indulging in “harmful tax competition”. On the contrary, most are not cutting taxes enough, especially payroll taxes, which act as a tax on employment. The central Europeans are shrewdly advertising low rates of corporate tax to attract foreign investors. But they make up for it with high rates of income tax, indirect tax, and social-security contributions. Hungary has one of the lowest corporate-tax rates in the EU, at 16%, but one of its highest value-added taxes, at 25%. Canny investors who make money there may then spend it in Germany, where VAT is just 16%.

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Charlemagne

The great debate begins

Feb 10th 2005
From The Economist print edition

Arguments over the EU constitution remain largely national

Get article background

LATE last year European Union ministers sat down in Brussels to draft a common declaration about the new European constitution. Since all 25 EU countries are meant to ratify this document over the next two years—and as many as ten will hold a referendum on it—it seemed a useful idea to set out succinctly what the constitution does and doesn't do. Useful: but, sadly, also impossible. The British suggested that it should be made clear that the constitution's Charter of Fundamental Rights would not limit the rights of managers to sack workers. But the Belgians and the French objected; as far as they are concerned the charter will do exactly that. All right, said the British and others: how about making clear that the constitution puts paid to the idea of a common EU tax? Not at all, said the Belgians and other federalists, for whom the creation of such a tax remains a cherished ideal. Eventually, the ministers abandoned the whole idea of a common declaration. Each country will be left to explain the constitution to its own citizens as it sees fit.

It was a revealing incident. For although the constitution is meant to express and promote European unity, national political cultures around the EU remain very different. Take Spain, which will be the first country to hold a vote on the constitution, on February 20th. (Three countries—Hungary, Lithuania and Slovenia—have already ratified it through parliamentary votes.) The Spanish are cheerfully and uncomplicatedly pro-European. They associate the EU with the end of Francoist isolation and the arrival of lashings of cash from Brussels. So although in one recent poll 88% of Spaniards said they knew nothing or “very little” about the constitution, 56% also pronounced themselves in favour of it. The Spanish government has been trying to popularise the text by handing it out at football matches. The contestants on the Spanish version of “Big Brother”, a reality-TV programme, were even forced to explain bits of the constitution to each other. (Some see the sections on “delegated European regulations and framework laws” as a little too sensational for a mass audience.) Such exercises reflect the Spanish government's real fear: not that the constitution will be defeated, but that the turnout will be embarrassingly low.

Yet the messages that Spanish politicians are using to sell the constitution would be completely alien in more Eurosceptic countries like Britain. Josep Borrell, a Spaniard who is president of the European Parliament, proclaims that “this constitution marks a shift from a primarily economic Europe to a political Europe.” This kind of statement is regarded as feel-good rhetoric in countries with strong Europhile traditions. Similarly, Jean-Luc Dehaene, a Belgian who was a vice-president of the convention that drafted the constitution, boasted recently to a Brussels audience that the constitution represented “a great step forward for the EU to become a true political union.” Were Mr Dehaene to try to say this in Britain, he would surely be bound and gagged by emissaries from Tony Blair's government. For this is precisely the message that Mr Blair is trying to stomp on. He believes that his government can win a referendum only by convincing Britons that, as Mr Blair put it in a speech last November, the constitution is “an expression of Europe as a union of nation-states...the rejection of Europe as a federal superstate.”

Disagreements of this nature are just one way in which the EU's constitutional debate will vary across Europe. National preoccupations also mean that different countries will fasten on different aspects of the constitution. Spain is far more concerned by the threat that Basque nationalists may try to break away from the Spanish state than by the debate over the EU constitution. But the two issues have become linked, because the Spanish government is trying to argue that article five of the constitution would mean that the EU would refuse to recognise an independent Basque state. It seems unlikely that any other country will pay such close attention to the constitution's provisions on “the territorial integrity of the state”.

Talking Turkey

A few months after the Spanish referendum, it will be the turn of France and the Netherlands to vote. In these two countries an issue is set to dominate the debate that has barely featured in Spain, despite its Islamic past: the prospect of Turkish membership of the EU. The extent of Muslim immigration into France and the Netherlands is deeply controversial. In both countries opponents of the constitution will seek to link the prospect of Turkish EU membership—and with it the prospect that Turks may gain an automatic right to settle elsewhere in Europe—to approval of the constitution. Those arguing for a yes vote will fire back (correctly) that Turkish membership of the EU has, strictly speaking, nothing to do with the constitutional treaty. But they are already resigned to the intermingling of the Turkish and constitutional debates.

Other countries will air other interests and obsessions. In Britain, opponents of the constitution will make much of the idea that the Charter of Fundamental Rights will give even greater scope for foreign judges to overrule British laws. In most of the rest of Europe, the idea of such a charter seems wholly unobjectionable. The British, by contrast, are relatively happy with moves towards closer defence co-operation, which may be deeply controversial in traditionally neutral Ireland.

In each EU country, in short, national governments will carefully tailor their messages to their domestic audiences. And that may be the only hope of getting the constitution approved in all 25 countries. European federalists sometimes bemoan the fact that Europe's babble of different languages makes it very hard to build a common identity and to stage pan-European debates. But, when it comes to getting the EU constitution ratified, it may prove to be a distinct advantage that Europeans do not share a common language.

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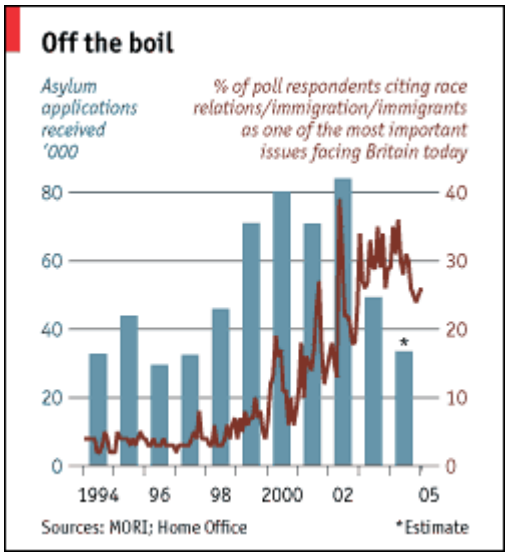
Immigration

Rolling up the welcome mat

Feb 10th 2005
From The Economist print edition

Tough talk on immigration may do the government more harm than good



"THE latest headline-grabbing initiative from a panic-stricken government." David Davis, the Conservative home affairs spokesman, went a bit over the top in his judgment of Labour's five-year plan for immigration and asylum: a government so certain of victory at the election expected in May can hardly be said to be panicking. But tough talk from the Tories and the loss of two ministers to immigration-related scandals in the past year have rattled the government; and, in attempting to recover its composure, it has gone far beyond a cure for present woes.

Until recently, ministers distinguished between two types of immigrant: those who come openly to Britain in order to work or live with their families and those who arrive clandestinely as asylum-seekers or illegal labourers. To the former they were kind, relaxing immigration rules and opening new routes to settlement. The latter were subjected to draconian new laws and a steady deprivation of legal rights.

The new plans, released on February 7th, signal an end to this distinction. It is not that the government is going soft on asylum-seekers and illegal immigrants: if Labour's plans are enacted, more would-be refugees will be locked up and may be deported after five years if the situation in their home country is deemed to have improved. Fines will be levied on bosses who employ illicit workers.

What has changed is that the government is now talking tough about foreign workers, students and wives. In future, rules allowing settlers to sponsor family members will be tightened. People turned down for work permits or student visas will not be allowed to appeal. Skilled would-be migrants will be assessed by means of a points system which, while it may not much alter the current criteria for judging who gets a work permit, will be more rigid and bureaucratic. Most striking are reforms aimed at less skilled workers, who will no longer be able to work their way towards citizenship—a nod towards a German-style guest-worker policy, which Britain has strenuously avoided until now.

Such initiatives are likely to show more tangible results than the government's plans to crack down further on asylum-seekers and illegal immigrants. The second group is smaller, elusive by nature and already so persecuted that further initiatives are likely to fall foul of Britain's courts. By contrast, it is easy to make life more difficult for foreign chefs. But will that appease Little Englanders?

Britons dislike workers and families much less than they dislike refugees. The flood of labourers began a decade ago: between 1993 and 1998, economic migration to Britain rose by more than half. But the proportion of people telling MORI, a pollster, that immigration is one of the greatest problems facing the nation, did not reach double figures until 1999, when the number of asylum claimants began to increase sharply (see chart). Worries continued to intensify as asylum numbers rose. Since 2002, both anxiety and numbers of asylum-seekers have eased, although attitudes have adjusted more slowly.

The Conservative Party (which wants an annual quota) and the government are now behaving as though immigration in general is unpopular. It is, but that may be because the public thinks the groups it dislikes make up a larger proportion of the total than they actually do. In a poll for *The Economist* in December, 86% of people cited asylum-seekers and illegal workers as the main cause of high immigration. Just 12% blamed workers and spouses.

Neil Gerrard, MP for Walthamstow, says some Labour MPs are worried about getting into a fight with the Tories over the scale of economic migration. As he points out, the Conservative Party will always be able to outmuscle Labour on the issue. Particularly as there is little chance that the Tories will actually be obliged to implement their policies before 2010 or so.

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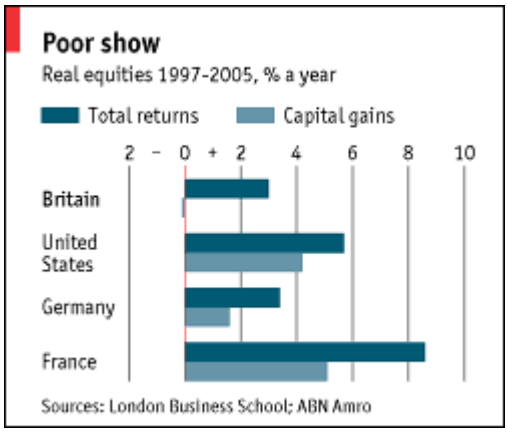
Equities

Unhappy returns

Feb 10th 2005
From The Economist print edition

Investors have done badly under Labour



SHARE prices have had a good run in the past few months. The FTSE 100 index has risen from around 4,300 half a year ago to break through the 5,000 barrier in trading on February 9th. That's the highest equities have been since mid-2002.

Unfortunately for investors, share prices will have to climb a lot higher before the FTSE 100 returns to its all-time peak of 6,930. The last time the stockmarket reached that level was at the end of 1999.

The bursting of the high-tech bubble is the main reason why the stockmarket has done so badly in the past five years. The IT, telecoms and electronics sectors have done spectacularly badly since early 2000, point out economists at the London Business School (LBS) in their yearly analysis of long-run global investment returns for ABN Amro, a bank.

Yet what is remarkable about the performance of the stockmarket is that equities have done so much worse in Britain than in other countries since Labour came to power in 1997. Since the start of that year, the real value of equities has shrunk by 0.1% a year (see chart). By contrast, it has grown at an annual rate of 5.1% in France, 4.2% in America and 1.6% in Germany.

The picture looks somewhat better for total returns, which include reinvested dividends. In real terms, total returns in Britain have been 3.0% a year. That's only a little less than Germany's 3.4%. The gap with America, where returns were 5.7% a year, also narrows. This is because British companies generally pay quite generous dividends. However, the French stockmarket still puts Britain's in the shade with total real returns of 8.6% a year.

Many investors will know whom to blame. Last year, John Littlewood presented a charge-sheet against the Labour government in a publication by the Centre for Policy Studies, a right-of-centre think-tank. He said that the stockmarket had been weakened by Gordon Brown's tax raid on pension funds. The chancellor's public spending spree was diverting resources from the wealth-creating private sector. And the Labour government was strangling companies with more and more costly regulations, which were eating into their profits.

Yet Mr Brown could quite legitimately retort that Britain's economy has done well with him in charge. Inflation has been tame, unemployment has fallen and the economy has relentlessly kept on growing. Germany may have outperformed Britain as far as stockmarkets are concerned, but Britain has been doing much better than Germany on the economic front.

But does a strong economy necessarily imply a strong stockmarket? It is natural to suppose that the two go hand in hand, since a buoyant economy should push up profits and dividends. Yet as Elroy Dimson, one of the authors of the LBS study, points out, the historical evidence does not back up the supposed link between growth and stockmarkets. If anything, strong stockmarkets tend to predict strong growth: investors get there first.

If this is the case, there is an uncomfortable corollary. Britain's poor stockmarket performance over the past few years may be signalling that the economy's long run of good performance will not last. In the general election campaign, Labour is making much of its record in managing the economy. Fortunately for the Labour government, any economic reckoning will occur safely after a spring election.

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Charles and Camilla

The prince's great matter

Feb 10th 2005
From The Economist print edition

Prince Charles pops more than one question

AP

Who'll wear the trousers?

Get article background

ONE of history's longer and more troubled courtships ended on February 10th. Five years after their first public appearance together and two decades after Prince Charles's first marriage became, in Princess Diana's words, “a bit crowded”, the prince is to marry Camilla Parker Bowles, his long-time lover. The wedding will take place on April 8th.

Why now? Because, it is said, they were fed up with the awkwardness their ambiguous status created. Three months ago, at the wedding of Charles's godson, they were given seats several rows apart, and consequently decided not to attend the ceremony.

The people seem ambivalent. In 1997, shortly before Princess Diana's death, a MORI poll found that only 13% of respondents reckoned Mrs Parker Bowles ought to become queen, while 67% were opposed. Last month, though, a Populus poll for the *Sun* found that 52% were in favour of the marriage. It did not ask whether Mrs Parker Bowles should become queen.

That difference of opinion may be why the royals have decided that Camilla will not be queen. She will be the Princess Consort, and the Duchess of Cornwall. That may require legislation. British politicians are likely to oblige, but other Commonwealth countries may also have to be consulted.

The other potential problem is the Church of England. Not that the couple wants to marry in church—the wedding itself will be civil, the blessing religious. But the Church, which Prince Charles will head if he becomes king, takes a dim view of the remarriage of divorcees. In 2002, the General Synod decided that officiating clerics could solemnise unions only in exceptional circumstances. It may look odd for a divorced man who has married a divorced woman to uphold the church's traditional opposition to remarriage.

Not that odd, though, to the Archbishop of Canterbury. He says that he is pleased and will officiate at the blessing, so it sounds as though the religious establishment has been squared.

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Freedom of information

The shoe pinches

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Arguments over the new rules on government secrecy

OPEN ministerial diaries to public scrutiny? Horrors, no! Disclose the attorney-general's advice to the government on the legality of the Iraq war? You must be joking! Reveal the financial assessments on which Treasury economic forecasts are based? Far too sensitive! Six weeks after the Freedom of Information Act came into force, squeals of pain can be heard rising from Whitehall as—in Lord Falconer's own words—the act's shoe begins to pinch. And this, the Lord Chancellor has suggested, might be "no bad thing". Many of his colleagues beg to differ.

Well-publicised examples of Whitehall's resistance notwithstanding, the act seems to have got off to a fair start. Within its first month, more than 4,000 requests for hitherto confidential or hard-to-access information were made across central government, half of them by journalists. The National Archives, which until now kept its records sealed for 30 years, has been the most solicited, with more than 600 requests, followed by the Ministry of Defence and then the Foreign and Commonwealth Office.

Although there has been grumbling about obstruction, most petitioners seem pleasantly surprised by what they have managed to dig up. This includes previously confidential information about Equitable Life's near bankruptcy, the government's decision to strip the Bank of England of its supervisory powers, Rupert Murdoch's lobbying the government over the communications bill, and the names of Tony Blair's dinner guests.

But other information is proving harder to get. Some ministers are said to be "apoplectic" over the suggestion that they disclose the contents of their appointments diaries, fearing they might be picked over for evidence of favours given to businessmen—though this is just the sort of thing the act is supposed to uncover. Sir Andrew Turnbull, the cabinet secretary, has come out in favour of disclosure. So has Lord Falconer, who chairs the cabinet subcommittee that is looking into the matter.

There was much anger over the refusal to release Lord Goldsmith's advice on the legality of the Iraq war, but the government was on firm ground. It can claim exemption from publication on 23 different grounds. In this case, it has relied on a triple defence of legal privilege (subject to an absolute exemption), matters concerning the "formulation of government policy" and international affairs (both subject to a public-interest test). The *Guardian*, which requested the information, has asked the government for an internal review, as it is required to do before it can appeal to the independent information commissioner. But it is now threatening legal action, accusing the government of deliberately dragging its feet.

This large number of exemptions suggests the act is wide open to abuse by government and other public bodies anxious to cover up negligence, laziness or worse. But the information commissioner, Richard Thomas QC, has the power to make life uncomfortable for those who try to

get round the act, including getting the courts to impose unlimited fines or even prison on the recalcitrant. He has promised to err, when necessary, on the side of the public's “right to know”. His ability to do so will largely determine the act's impact.

The Tories are angry not about what hasn't been revealed but what has. They have accused the government of “dirty tricks” in the run-up to the general election—using the act to dig up stuff that they would rather stayed hidden, in other words. They are particularly aggrieved over this week's release of sensitive Treasury documents relating to sterling's humiliating expulsion from Europe's exchange-rate mechanism under a Tory government on “Black Wednesday” in 1992. The documents were not quite as gripping as the row over them, however: the most interesting thing they revealed was that the operation to prop up sterling cost not the £10 billion usually bandied about but £3.3 billion.

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Sailing

Around the world in 71 days

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AFP

A record is broken

WHEN Ellen MacArthur, a British sailor, left the Cornish port of Falmouth last year, she was already a tiresomely familiar celebrity. When she returned on February 7th, proud owner of a new world record for sailing single-handed around the globe, the acclaim was deafening.

She is not the first person to circumnavigate the world (Juan Sebastian del Cano, Magellan's second in command, Magellan having died en route), or the first Briton (Drake). Nor is she the first person to do it non-stop and solo (Sir Robin Knox-Johnston), the first woman (Kay Cottee) or the first in a trimaran (Nigel Tetley). But she is the fastest: her time (71 days and 14 hours) was over a day quicker than the previous record.

The media descended on the tiny port and treated her as a conquering hero. Tony Blair announced she would become a dame (the female equivalent of knight) before she had even arrived.

Not everybody shares Mr Blair's admiration. Curmudgeons have pointed out that her ship (named *B&Q/CASTORAMA* after the retailers sponsoring her) is crammed with fancy navigation equipment and a satellite link—not in the spirit of a solo trip. Others have complained about the nakedly commercial nature of the voyage (Kingfisher, B&Q's parent company, which has spent £12m on Miss MacArthur since 1998, reckons that the publicity is worth £100m—$185m—and counting). But sailing has always been a commercial business: Drake is a hero at home, but the Spanish thought him a pirate; the *Cutty Sark*, a tea clipper turned romantic tourist attraction, was built to move cargo between Britain and China as quickly as possible.

In the end, despite the complaints, most of the comment was favourable. Indeed some of it was strikingly so: one pundit described Miss MacArthur as the greatest British sailor ever. That's going a bit far. After all, 2005 is nautically notable for another reason: it marks two centuries since

Admiral Lord Nelson's victory at the Battle of Trafalgar.

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Road pricing

Crawling traffic

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Can road pricing spread beyond London? Not without a push

TWO years after London introduced one of the most radical road-pricing schemes in the world, other parts of Britain are still hesitating about whether to follow suit. That is not because London's scheme hasn't worked: on most counts, it has been a triumph. Journey times in the central London zone covered by the scheme are down by a third and air pollution has fallen by 12%. Bus usage is up by more than a third, and 80% of the people who pay the £5 charge for entering the zone between 0700 and 1830 say they are happy with the way the scheme is run. Some businesses inside the charging zone do say they have lost trade—although none of those citing this have so far won appeals to have their property taxes reduced.

That, coupled with worsening congestion, should encourage other places to copy London. Of the 35 local authorities which have expressed interest in principle, the one closest to doing anything is Edinburgh, which this week started a postal referendum on introducing a two-tier scheme covering both commuters into the city and traffic in its historic centre. But the city council has mishandled presentation of the plan, in particular over exemptions. Polls suggest that the result, due on February 22nd, will be negative.

Until recently, progress in other parts of the country had stalled. Bristol, which was originally enthusiastic about congestion charging, dropped its plans when the Liberal Democrats took control of the council. Although national party policy supports road pricing, local parties take sharply different views: Edinburgh's Lib Dems have been strong opponents of the scheme there. Plans for a road-pricing scheme in a heavily used bit of the Peak District National Park, in Derbyshire, are on hold, as is a congestion-charging scheme in Cardiff, and a planned workplace parking levy—broadly the same thing—in Nottingham.

Two things are needed to change this, says David Begg of the Commission for Integrated Transport, a government-funded body that promotes public transport and road pricing. The first is a financial incentive from central government. That is coming: the government's newly established Transport Innovation Fund, which aims to encourage local authorities to take politically unpopular decisions, is expected to get £250m a year, rising to £2 billion by 2014. In future, cash for public-transport schemes may be tied to road pricing. A new tram system in Leeds, for example, will get funding only if the council brings in road pricing. Otherwise, says Mr Begg, the improved public transport will have no effect on congestion.

The second is a change in local government. Congestion charging is most likely to work when it is backed by a big local authority, covering all or most of a travel-to-work area, with power over both roads and public transport. That is the case in London, but nowhere else. In big congested cities like Birmingham, for example, the body responsible for public transport has quite different boundaries from the city council. That makes co-ordination difficult. In Edinburgh the city council covers too small an area; neighbouring councils, whose voters think they will lose out if the scheme goes ahead, are threatening legal challenges if the Edinbourgeois say yes.

Local government

Who knows best?

Feb 10th 2005
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Why local councils are treated like naughty children

HOW good are Britain's local councils at giving voters what they want? You might expect the voters to be the best judges of that. Happily, though, the task is not left solely in such unqualified hands, for there are plenty of central government agencies to help them. So, for example, we now know that Worthing council has a patchy record when it comes to making the folk there more cultured. “Although there is an adopted community strategy and cultural strategy, which give an overarching framework and reflect community needs, the aspirations, priorities and objectives in these have not been translated into clear long-term targets or consistent priorities for council services,” muses the Audit Commission, which marks councils.

James Strachan, the Audit Commission's chairman, announced this week that he wants to halve the cost of public service inspections. Mr Strachan has a battle on his hands, though, for his inspectors do not do this stuff for fun. Britain has an unusually centralised system of government under which the centre provides three-quarters of the money spent locally. It therefore likes to know what councils have done with the cash. And this tendency has been exacerbated by the government's hunger for data to monitor public-sector output so it can show that taxpayers' money has been well spent.

The drift to more inspection and regulation of the public sector, which began under the Tories, has accelerated recently. Attempts to count up the regulators have ended in failure because of their sheer number, according to Tony Travers of the London School of Economics. And this trend is unlikely to go into reverse. “The Audit Commission and some at the centre of government do want to decentralise,” says Sir Sandy Bruce-Lockhart of the Local Government Association, “but the spending departments still want information to show that they have met their targets.”

Sometimes that information concerns useful things, like how much waste the council has recycled, or whether its schools are getting good exam results. But often the council is asked to provide less crucial performance data. Westminster council says that of the 140 performance indicators it has to provide every year, at least 20 or 30 are redundant or useless. They include numbers on satisfaction with Westminster's museums and theatres, even though none of them is owned or run by the council.

In theory, well-behaved councils are subject to less interference and trusted to get on with their jobs. The phrase used to describe this is “earned autonomy”, which is odd given that councils get their mandate from voters. But in practice, independence for good councils has been less forthcoming than they had hoped.

For those who get bad ratings, the preferred solution is more help from the centre. Kingston-upon-Hull was the only council to be rated “poor” in the last round of assessments. Since the start of this year, according to Kim Ryley, Hull's chief executive, the council has played host to OFSTED,

which inspects schools, a “youth offending team inspection”, a “youth service inspection” and a “supporting people inspection”. They already have the Audit Commission and a special government team working with them. And there have been two meetings with a monitoring board and a session with the Audit Commission on the annual report, too. “We're finding it difficult to concentrate on making the changes that everyone tells us we ought to be making,” says Mr Ryley.

But does all this actually do harm? It certainly costs over £500m a year for central government to discover what is going on in local government, up from £250m in 1997. This money, which excludes the cost to the inspected, comes from central government's grant to councils, so it might otherwise be spent on services.

Perhaps more seriously, though, it comes between councils and voters. This is bad for voters, who should be allowed to decide for themselves if they are getting a good deal, and for councils, which must please both Whitehall and their electorate. “As a council, you are torn between two sets of judges,” says Mr Ryley.

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Marketing Luton

Hard sell

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From The Economist print edition

How to persuade people to love their town

IF A Yorkshire town were transplanted to the south of England, it would look much like Luton. The city not only has a shrunken industrial sector and a struggling football team; it also contains houses so unreconstructed that they sometimes attract film crews in search of northern grit. But there is one vital difference. Unlike the inhabitants of Yorkshire, Lutonians do not talk up their home to outsiders.

“I believe it is the worst town in the entire southern half of England,” declares Radoslaw, a factory worker, who goes on to compare Luton unfavourably with the cities of his native Poland. It is a typical view, according to Peter Morris, head of communications at the borough council. It is also a problem, since bad vibes may deter potential migrants and investors. But not, perhaps, for long.

Luton First, a public-relations outfit funded by the council, the nearby airport and assorted local businesses, has already produced a nifty brochure explaining that the town lies “between London and Birmingham, Oxford and Cambridge”. More tenuously, Luton First put up signs last year announcing that the town was twinned with Barcelona, Dublin and Athens. It isn't (it is twinned with the home of Volkswagen cars and a Berlin suburb, among others). The point was to persuade locals that their home town was, like the more celebrated European cities, a cultural, economic and educational hotspot.

The campaign to promote Luton is now in the hands of Anthony Edwards, a publicity consultant who formerly touted London's Carnaby Street and Savile Row. Mr Edwards approached his new brief by asking an unusual question: why is Paris associated with romance and culture, while Luton is not?

The answer has little to do with inherent differences, he believes: rather, Paris owes its reputation to literary praise. The key to selling Luton is therefore to get people to write nice things about it. To which end an anthology, “Junction 10”, is in progress (the title refers to an exit from the M1 motorway). Another report, “Luton in Love”, will be released on February 14th. Local response to both projects has been good, says Mr Edwards. “The number of romantic poets cropping up in Luton is quite amazing.”

It is a brave campaign, although not a unique one these days. Burnley, in Lancashire, is also trying to advertise its strengths to residents by means of a poster campaign. There, civic marketing is a serious matter: the town fractured along racial and religious lines following a minor riot in 2001. In Luton, by contrast, the goal is more mundane. Mr Morris will judge the success of the campaign by what the locals say when they meet strangers on holiday. “Hopefully, instead of having to say they come from Bedfordshire, they can say, ‘I come from Luton.'”

Bagehot

Lessons from Maggie

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Tony Blair is an admirer of Margaret Thatcher. That should help him learn from her biggest mistake

A DOMINANT prime minister who has won large majorities in three consecutive elections is prematurely ejected from Downing Street because of Europe; a bitter legacy of resentment does great and lasting harm to the former prime minister's political party. The story of Margaret Thatcher's fall from power sounds a long way from Tony Blair's brilliant career; but it does not take too great a leap of the imagination to see how the same fate could overtake him with similarly disastrous consequences for Labour.

What prompts these thoughts is the coincidence of a Commons debate on the referendum to decide whether Britain should sign the European constitutional treaty with the publication of "Maggie: Her Fatal Legacy" by John Sergeant, the BBC's former chief political correspondent. Much of Mr Sergeant's story will be familiar to anyone with a longish political memory: the erosion of support for Mrs Thatcher because of panic about the poll tax and exasperation over her increasingly strident anti-Europeanism; her shocking expulsion from office; her mounting disillusion with John Major, her chosen successor; her sniping from the sidelines as he attempted the impossible task of uniting his party while conducting a sensible European policy.

More contentiously, Mr Sergeant shows how Mrs Thatcher's sense of injustice and need for revenge undermined the Conservative Party for more than a decade after she ceased to be prime minister. Having convinced herself (with the help of ideologically sympathetic cronies) that she was putting country before party, she campaigned against Mr Major without restraint. She gave undeserved legitimacy to those who rebelled against Mr Major over Europe and ensured that the party would fail to recover from sterling's messy expulsion from the ERM—an episode which still dogs the Conservatives today (see article).

Having helped to destroy Mr Major, she continued to exercise her influence to prevent anyone she suspected of being insufficiently Thatcherite—Kenneth Clarke in 1997 and both Michael Portillo and Mr Clarke again in 2001—from becoming leader. Not content with having helped land the party with hopeless leaders, she sneered at their inadequacies when, predictably, they did not match up to her unrealistic expectations. On leaving Downing Street, Mrs Thatcher warned that she would be "a good backseat driver". Instead, she was in large part responsible for the wreck that is the modern Tory party.

At first glance, any comparison with what could happen to Mr Blair might seem absurd. After all, Mr Blair has already announced that he is not going to fight an election after the one he is expected to win in May. Unlike their Tory counterparts in 1990, if Labour MPs in the next parliament fear Mr Blair would lose them their seats in the subsequent election, they will not need to oust him. While there are some anti-European Labour MPs, they are regarded within the party as relics of the past rather than serious troublemakers. Yet Europe is still the issue that has the potential to ensure that Mr Blair abides by Enoch Powell's dictum that all political careers end in

failure.

Since the publication of a poll by ICM in the *Sunday Telegraph* on January 30th suggesting that opinion on the European constitution is much more finely balanced than had previously been thought, assumptions about the outcome of next year's referendum have changed. “No” campaigners are no longer so certain of victory, while the pro-Europeans' defeatism has been replaced by a new mood of optimism. Faced with the actual question to be put to the British people—“Should the United Kingdom approve the treaty establishing a constitution for the European Union?”—39% said yes and 41% no. This week, a Populus poll for the *Times* putting the same question, but reminding respondents that there would be a referendum next year, found 36% in favour and 29% against. Compared with other polls on the issue, such as a recent one by YouGov, indicating opinion running nearly two to one against the constitution, this looks like a stunning reversal of opinion. Suddenly, Mr Blair's confidence in a yes vote looks a good deal more convincing.

But Mr Blair would be wrong to read too much into these polls. Even if Britons can be persuaded to think more fondly of Europe by the time of the referendum, the government may still be unpopular enough for voters to want to give it a kicking when they can do so without the risk of getting a Tory government. By-elections, local election results and the rejection a few months ago of John Prescott's plans for a regional assembly in the north-east all show that. Moreover, voters' willingness to trust Mr Blair has collapsed in the past two years (though, oddly, faith in his competence has not).

It is thus all too possible that the government will lose the referendum because a lot of people now think (unfairly) that Mr Blair is a liar. Worse still, as YouGov's Peter Kellner points out, if the margin of defeat is narrow, post-referendum opinion polling will show that Mr Blair himself lost the vote. At that point, there will be pressure on him to stand down so that Gordon Brown can try to secure a yes vote later on.

Nothing so became him

Would Mr Blair go quietly? There are few precedents of prime ministers at the peak of their powers (Mr Blair will be 52) with hefty majorities (as seems likely) waving a cheery farewell as they set off to explore their hinterland. Mr Blair might instead tell himself he had promised to serve three more years and should stay on in order to protect his legacy of public-service reform from Mr Brown. Things could turn nasty very quickly.

The lesson Mr Blair should take from Mr Sergeant's book on Mrs Thatcher is simple: go before you are pushed and then allow your successors to get on with the job, however badly you think they are doing it.

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Hewlett-Packard

Exit Carly

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From The Economist print edition

EPA

Looking lost, a troubled firm changes driver without changing course

Get article background

“THIS is not a change related to strategy; this is a change...to accelerate the strategy.” Thus Patricia Dunn, hours after becoming chairman of Hewlett-Packard (HP), one of the world's largest technology firms, tried to explain in a call to financial analysts on February 9th why she and her fellow directors had, a day earlier, asked Carly Fiorina to resign as HP's chairman and chief executive. But what exactly is HP's strategy?, Robert Wayman, HP's finance chief and now interim chief executive, was asked in a second call with the press. After a hem and haw, Mr Wayman replied that there are “a variety of strategies”, which all have to do with HP's “unique portfolio of businesses”. This begs the real question: uniquely what?

Although Ms Dunn and Mr Wayman bravely insist that Ms Fiorina's shortcomings lay in execution, not in setting a wrong overall direction, almost everybody else disagrees. “Execution problems usually follow from a flawed strategy,” says John Slocum of the SMU Cox School of Business in Dallas. HP's real challenge, he thinks, is that “they have to decide what they want to do. What is HP?”

That this question is now so hard to answer is in large part Ms Fiorina's fault. She became HP's boss five years ago, just as the technology industry was peaking. Her mandate was to transform the company. Her chosen strategy was to do this through a controversial merger with Compaq, a Texan firm a world apart culturally from HP's Silicon Valley ways but, like HP, struggling to cope with fierce competition in the computer industry. By turning two large and bloated rivals into one huge and leaner operation, Ms Fiorina hoped, HP could make its computer business as profitable

as its printer business, in which it is the unchallenged world leader.

Blame Dell

That is not at all how things turned out. In printing and imaging, HP is doing as well as ever. But in almost every other line of business it has run into problems. In personal computers, HP has been fighting a disastrous price war with Dell, a rival that sells direct to customers rather than, as HP does, through many channels, and whose supply chain is much more efficient. In corporate computers, HP has been squeezed between Dell at the cheap end of the market and IBM at the expensive end. HP is also losing market share to focused rivals such as EMC in corporate data-storage systems. In information-technology services, HP lags far behind IBM, Accenture and EDS. In consumer electronics, HP is up against everybody from Kodak to Sony.

With such sprawl, perhaps it is not surprising that the firm's performance has suffered. Ms Fiorina apparently resisted suggestions that she hire a chief operating officer who could have helped her to cope with the details. As a result, says Carl Claunch at Gartner, a technology-research firm, execution has been “inconsistent”, not only from one quarter to the next—HP had an embarrassing earnings dip last August, for which Ms Fiorina fired three of her top lieutenants on the spot—but also between divisions. In corporate computing, for instance, HP has been touting a vague slogan about the “adaptive enterprise”, but has found it hard to explain to customers what that actually means. In particular, HP seems to have lost its way in the highly competitive data-storage industry. With frustration running high inside the company and resentment growing over Ms Fiorina's tough management style—which clashed with the collegial culture that HP staff were used to—managers started leaving to join rivals.

Ms Fiorina laboured on through the criticisms, doggedly defending her merger with Compaq and insisting that “synergies” would eventually make HP a leader in all of its businesses. The stockmarket, however, ignored HP's public-relations blather and answered the question “what is HP?” in a brutally clear way. Since the merger, HP's market capitalisation has been roughly equal to the value of its printer business alone. To Wall Street, in other words, HP is a printer company, with a few worthless distractions on the side.

This horrid performance has led to calls that HP be broken up. One of the first to make this case, a year ago, was Steven Milunovich, an influential analyst at Merrill Lynch. Other analysts have since taken the same position. But the closest that Ms Fiorina—who in her previous job at AT&T spun off its telecoms-equipment arm, Lucent—came to engaging in this debate was to concede that HP's board discussed the issue three times, and then decided against a break-up. As if to tie its own hands, HP even announced in January that it would merge the printing and the personal-computer business into one division, in effect making the winner subsidise, or cover up, the loser.

The ousting of Ms Fiorina therefore does not automatically mean that a break-up is now likely. The same board that has decided against it three times already, and this week pledged allegiance to HP's strategy—whatever that is—will now be looking for a new chief executive.

Even so, HP's shares jumped by 10% in the hours following the announcement of Ms Fiorina's resignation. At least in part, that was because “the long-term probability of a break-up of the company is rising”, says Mr Milunovich, who promptly raised his recommendation to “buy” from “hold”. His favourite to replace Ms Fiorina would be Michael Capellas, who ran and sold Compaq to Ms Fiorina in the first place, and who now runs and is negotiating to sell MCI, a telecoms firm.

Gartner's Mr Claunch, by contrast, thinks that HP's board, if it even remotely believes its own rhetoric about better execution, is unlikely to hire an avowed deal-maker such as Mr Capellas, and should instead look for a “details guy”. As for Ms Fiorina—elegant and intellectually versatile—

nobody expects her, at 50, to disappear with her $21m severance package. Even at HP, she never quite dispelled rumours of an interest in politics.

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Unilever

Slim fast

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The Anglo-Dutch giant is in bad shape

UNILEVER has long been dogged by odious comparisons. As an Anglo-Dutch multinational with two boards and two stockmarket quotations it is often compared with Royal Dutch/Shell (see article). And as a consumer-goods giant heavily into soaps and spreads, it invariably has to stand comparison with its American rival Procter & Gamble (P&G). So, with Royal Dutch/Shell having decided to abandon its dual structure, and P&G last week acquiring Gillette (for $54 billion), expectations have been rising that Unilever would follow suit.

The company's announcement, during the presentation of its annual results on February 10th, that Patrick Cescau, its London-based co-chairman, is to become chief executive while Antony Burgmans, the Dutch co-chairman, becomes non-executive chairman until his retirement in 2007, duly paved the way for the unification of the binational company.

But there is so far no sign of a deal that would help Unilever to catch up with the new P&G/Gillette combination. Colgate- Palmolive, an American maker of toothpaste, and Reckitt Benckiser, a European household-products company, are possible takeover targets. But Reckitt, for one, would be expensive. On February 9th it announced an increase in its pre-tax profits to £770m ($1.4 billion) from £660m in 2003. Moreover, Unilever's debts are high: at the end of December net debt stood at €12.5 billion ($15 billion).

The company needs to sort out its own problems before it takes on the complex integration of another business. Last year sales were down by 6% and operating profits slipped by 9%. In September 2004 came the group's first ever warning that it would not deliver a promised increase in profits. That led it this week to scale back the performance targets it had set itself for the next five years.

Mr Cescau will be given four years to turn the company round, says Andrew Wood, an analyst at Sanford C. Bernstein, an investment-research firm. At the beginning of 2000, P&G was a basket case and Gillette was in bad shape, Mr Wood points out. Their turnarounds took that long.

Analysts say that Unilever's main problems are too little (and misdirected) advertising; unrealistic performance targets; some unattractive products; and a lack of innovation. The firm spends 14.5% of its revenues on advertising, which is more than the 12% spent by Nestlé, the world's biggest food firm, but far less than the 20% that P&G splashes out on promoting its products. Victoria Buxton, an analyst at Lehman Brothers, says that the problem also lies in the way that the company spends its advertising budget. It made a mistake, she says, in sacrificing longer-term advertising on television and other media for short-term promotions in an effort to stem its loss of market share.

Unilever could also sell some of the businesses that have failed to contribute to growth over the

past couple of years. Slim-Fast, a weight-loss brand that it bought for $2.3 billion in 2000, household-care products, so-called prestige fragrances and frozen foods together account for about 10% of the group's sales. But they make scarcely any money. Analysts mostly reckon that some of these could go, but a big disposal is unlikely. Mr Cescau is believed to take the view that Unilever has in the past been too quick to sell its problems.

It has, however, been too slow to introduce new products. It failed to react to the worldwide craze for the low-carbohydrate Atkins diet in 2003. Thanks to Atkins, Slim-Fast's global sales dropped by nearly 30%. Now that Atkins seems to be going out of fashion, Slim-Fast is belatedly venturing into low-carb foods. Last month, the group's new low-carb and low-calorie shakes, soups and cereals went on sale in Britain, France and the Netherlands.

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Anglo-Dutch companies

From rivalry to mergers

Feb 10th 2005
From The Economist print edition

A brief history of the Anglo-Dutch business model

FOUR centuries ago, within 15 months of each other, the English and the Dutch set up rival East India companies. In 1826 a British foreign minister sent his country's ambassador in The Hague a (coded) message: “In matters of commerce the fault of the Dutch is offering too little and asking too much.” But business is business: why compete when you can combine? The two East India companies soon found it easier to trade in separate bits of Asia.

A century ago, the countries' rival oil companies agreed, as their joint history now puts it, that they “would do better working together”, and in 1907 created Royal Dutch/Shell. In the 1920s, Margarine Unie, a Dutch-led quasi-cartel, saw Lever Brothers extending from soap into food. In 1930 the pair became Unilever.

Much later came three other big Anglo-Dutch mergers. In 1993, Elsevier, a Dutch publisher, merged with Reed, a one-time paper firm that had spread into publishing. In 1999 British Steel and Hoogovens united as Corus, and Britain's Reckitt & Colman merged with a Dutch household-products rival, Benckiser.

Reckitt Benckiser has been a success. Avoiding errors made by the others, the two firms were swiftly and fully integrated into one; this week it reported record profits. But elsewhere “national” stresses have sharpened business ones. Royal Dutch/Shell was a merger of operations only: the group is still 60% owned by its Dutch parent, 40% by its distinct British one. Only last October, under fire for its oil-reserve accounting, did the two decide to become one, Royal Dutch Shell PLC, listed in London but headquartered in The Hague. Reed Elsevier is still owned 50-50; up to 1999 it was also two warring boards and headquarters, until a new Dutch ex-Unilever chairman brought in a British boss and a unified management structure.

Corus set off in 1999 proclaiming unity, but with a carefully balanced Anglo-Dutch board and joint chief executives. It soon lost them, and $1.5 billion in its first 15 months. A new sole—and British—chief executive did not end the clashes, as Dutch profits were eaten by losses in Britain. In early 2003, the supervisory board (the new CEO plus three Dutchmen) that has a say in Corus's Dutch operations rejected the sale of some profitable aluminium plants there. Corus was at war with itself, a war ended only by the arrival of a new chief executive—from France.

Unilever avoided most such problems. Although it has two parents, Unilever NV and Unilever PLC, chaired by Antony Burgmans in Rotterdam and Patrick Cescau in London, the same people sit on both boards; each chairman is vice-chairman to the other (awkwardly, both are “co-chairman” of the group). But now Mr Burgmans will be non-executive chairman. Mr Cescau will be chief executive. He has one advantage: like his counterpart at Corus, he's neither British nor Dutch but French.

Tobacco litigation

Smokin'

Feb 10th 2005 | WASHINGTON, DC
From The Economist print edition

A victory for big tobacco

Reuters

A future litigant?

LAST September, the American government's huge lawsuit against big tobacco firms finally went to trial. The government accused the firms of a conspiracy to hide the risks of smoking, and wanted them to hand over a staggering $280 billion in “ill-gotten” gains. Barely five months later, the government's chances of imposing this draconian punishment look slim.

On February 4th, a federal appeals-court panel ruled that the government will not be allowed to get its paws on the firms' profits. The ruling, if it sticks, takes the sting out of the lawsuit, which is proceeding in a lower court. It leaves only the possibility of milder sanctions—perhaps forcing the firms to cover smokers' quitting costs or to submit to yet more restrictions on marketing. Tobacco shares soared on the news. But the government, which declared war on tobacco under President Bill Clinton and has spent $135m so far waging it, may appeal the decision by the three-judge panel to the full appeals court, where it has a decent chance of winning a reversal.

Meanwhile, the broader legal war against tobacco continues. The industry is anxiously awaiting the Florida Supreme Court's ruling on whether it will reinstate a $145 billion verdict won by more than 700,000 sick Florida smokers in the *Engle* case. History is on big tobacco's side: courts have taken a dim view of these basic personal-injury cases cloaked as class actions. The appeals court that threw out the *Engle* verdict in 2003 also said that the plaintiffs had no business suing as a class.

Philip Morris is fretting over the Illinois State Supreme Court's pending ruling on its appeal in another case. The plaintiffs used a novel tack that won them a $10.1 billion verdict in 2003. These smokers, instead of suing for harm done to their health, claim that Philip Morris duped them into believing that its more expensive “light” brands were healthier than its regular ones. If they had known better, say the smokers, they would have saved their pennies. The firm needs the support of four out of five judges to reverse the ruling.

Light-cigarette cases of various sorts are proliferating—the current fashionable threat to the tobacco industry. Tobacco firms are being blamed for failing to give warning to smokers that they might unwittingly be taking deeper drags or blocking the ventilation holes with their fingers while smoking these low-tar cigarettes. And, in contrast to basic personal-injury tobacco lawsuits, the courts seem more open to allowing these cases to proceed as class actions.

Two more new waves of litigation are coming, says Bill Farone, a former Philip Morris executive

who now testifies often against the industry. Now that the technology for fire-safe cigarettes exists, people are suing when cigarettes start fires. Second-hand-smoke lawsuits, too, are likely to mean big trouble for tobacco firms as other litigants follow the lead of some Florida air-stewardesses, who finally wrangled payment from the industry last year. It may prove hard for tobacco firms to argue convincingly that plaintiffs should have known about the risks of smoking when they never took one puff on a cigarette.

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Biotechnology

The triumph of the commons

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Can open source revolutionise biotech?

Get article background

THE computing industry has been transformed by open-source software, threatening business models while creating lucrative opportunities for some firms. Might the same happen in biotechnology? In a paper published in *Nature* on February 10th, a group of researchers describe a way to transfer genes into plants that bypasses the now most commonly used technique, agrobacterium transformation, which is protected by hundreds of patents. The new process may provide an alternative method of modifying certain types of crops in order to, say, improve harvests. But what makes the invention particularly notable is that the authors, affiliated with CAMBIA, a non-profit biotech research group in Australia, have made the procedure free for use under a novel “open-source” licence.

This licence allows people to commercialise products based on the procedure. All that is required is that improvements to the technique itself be shared, to the benefit of all users. This should make it easier for companies and researchers in poor countries to use agricultural gene-transfer technology, which today's patent-licensing approach impedes.

“The idea is to try to craft a system so that we have a different way to do business,” says Richard Jefferson, the head of CAMBIA and a co-author of the paper. “This is a demonstration of a way forward for an innovation business model,” he says, which could help unleash creativity in poorer countries. This week, the group also unveiled a website, BioForge.net, to help biotech researchers to collaborate, much as SourceForge.net is a nexus for open-source software development.

Although open-source approaches have already been used in biotech-related computing (called bioinformatics) and database sharing, CAMBIA's licence represents an actual technique being provided in an open-source form. It is part of a broader push towards open practices in the life sciences. For example, Science Commons, an offshoot of Creative Commons (which provides less restrictive copyright licences to authors), is preparing to develop open licences later this year.

CAMBIA's technique, and its open-source licence, “is a potentially huge deal for people working in minor crops, on humanitarian projects, and even for smaller companies working with the major crops,” says Lisa Lorenzen of Iowa State University. Calestous Juma of Harvard University's Kennedy School of Government believes the approach is viable because “you have the incentive to invent, but you also have the raw materials—information—with which to invent.”

The dominant patent holder in agrobacterium transformation, the most widely-used means of plant gene-transfer, is Monsanto, a big agricultural firm. The firm says that, although it is not very familiar with open-source approaches in the life sciences, the technology seems to complement, not threaten, its business model.

In information technology, some firms, including mighty Microsoft, are severely threatened by open source. Yet other firms, including big ones such as IBM, have evolved business models to embrace open source, which contributes greatly to their revenues. The question is, can open-source biotech also find its way into drug development, where the costs are higher and potential profits greater?

Pedants will note that CAMBIA's approach is not pure open source, since the group relied on grants from foundations to develop the technology rather than on volunteers. Moreover, the licence itself is not completely unique, in that royalty-free, non-exclusive technology agreements that stipulate sharing improvements have existed before. But these are quibbles. The open-source-like approach may not revolutionise the biotech industry, but it is a notable step in a new direction.

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Corporate performance

A world awash with profits

Feb 10th 2005 | HONG KONG, LONDON, NEW YORK AND PARIS
From The Economist print edition

Business is booming almost everywhere

GIVEN how easy it has been to find something to worry about, be it the plummeting dollar, war in Iraq or the crookedness of so many corporate bosses, it has been easy to miss one extraordinarily positive economic trend: for companies around the world, on average, business has never been better. Balance sheets are strong, boardroom confidence is sky high and, most striking of all, corporate profits are at record levels.

Profits tend to grow fastest in the early part of a recovery, when firms use spare capacity to raise output at little extra cost. As America's economy began to grow again in early 2002, profits duly shot up. But, ordinarily, profit growth slows as the cycle matures, firms hire more workers and costs rise. Intriguingly, this has not yet happened in America, despite three years of strong growth. Last year, the operating profits of the big, publicly-listed firms that make up the S&P 500 stockmarket index grew by an estimated 20%, after 19% growth in 2003. From tech firms such as Google to industrial and financial behemoths such as General Electric, America's bosses continue to spring pleasant surprises on grateful shareholders. With most results announced, profits for the fourth quarter of 2004 ought comfortably to beat the 15.1% growth, year-on-year, which the market has been expecting, says Thomson Financial, a research firm.

Things are similarly positive across the Atlantic. In Britain, the huge profits of two oil firms, BP and Royal Dutch/Shell—Shell's $18.5 billion beat the previous British record set last year by HSBC, a bank—have even prompted wishful left-wing talk of windfall taxes. On the continent, Puma, Europe's third-biggest maker of sportswear, reported a 44% increase in net profit for 2004 on February 7th. Then Renault, France's second-biggest carmaker, reported a 43% rise in net profits to €3.6 billion ($4.6 billion). France's two big luxury-goods conglomerates, Moët Hennessy, Louis Vuitton and Pinault-Printemps-Redoute, have also had a good year. Together, the operating profits of the big firms tracked by the S&P Europe 350 index rose by a striking 78% last year; they are forecast to grow by a further 30% this year. A survey this week of chief executives by Goldman Sachs found European bosses even more upbeat than their peers in America.

Economists take it for granted that profits cannot grow by more than nominal GDP over the medium term. But there are two reasons why profits could defy this conventional wisdom. The first is that it is all an accounting fiction: firms consistently overstate reported profitability. They tend to punctuate periods of oddly rapid growth with occasionally awful years of massive write-offs: admissions, in other words, that past profits were overstated. In 1989-2004, says Goldman Sachs, write-offs among the firms included in the S&P 500 index tended to fluctuate between 5%

and 15% of total reported earnings per share (EPS) each year. But there were two notable exceptions: in 1991-93, write-offs rose to 30% or more of reported EPS, setting the conditions for lots of weirdly quick profit growth later in that decade. In 2002, write-offs soared to an astonishing 140% of EPS. Bosses have not looked back since.

The second explanation is that corporate profits can win a bigger slice of national income, and thus temporarily grow faster than the overall economy. According to Merrill Lynch, after-tax profits in America (based on national-accounts data, which is more reliable than firms' reported data) rose from about 5.5% of national income in the early 1990s to more than 9% in 2003. American profit margins are now close to a record. The picture is remarkably similar elsewhere. The share of profits in GDP both in Europe and Japan is close to a 25-year high. Taken as a whole, the share of profits in national income for the G7 rich economies has never been higher, calculates UBS.

Don't worry, be happy

Predictably, this profit boom is spawning its own worries. Some pundits agonise that profit growth built on the impoverishment of workers at home and the export of jobs abroad as firms outsource operations to China and India cannot be sustained: consumer confidence will fall, demand will plummet and profits will collapse.

Others worry that America, in particular, relies too much on financial firms as a source of profit growth. Since 1982, the profits of financial firms in America have risen from 4% of overall profits to more than 40%. (Neither Europe nor Japan has experienced the same phenomenon.) As a whole, the finance industry makes up nearly one-quarter of America's overall stockmarket capitalisation, up from a bit over 5% in the 1970s. Bill Gross, a bond-market veteran, adds these numbers to soaring consumer debts to arrive at what he calls the “finance-based economy”—a perilous venture sustained by the Fed's super-low interest rates.

More optimistic souls point to the sort of arguments that fuelled the sharp rise in share prices and talk of a new economy in the 1990s. Globalisation continues to combine with whizzy new information technologies to boost productivity. Compared with booming profits, rich-country workers have lost out, as Chinese factory workers, Indian software engineers and the spread of computer automation undermine bargaining power and wage growth. On the other hand, these same forces are depressing prices and ushering in life-improving products and technologies, making everyone wealthier and more eager to consume.

The beneficial impact of sourcing in the Chinese and Indian economies may continue for many more years. A recent survey of 248 chief financial officers in Asia by *CFO Asia*, a sister publication of *The Economist*, found many of them complaining of intensifying competitive pressures: 51% of manufacturing bosses said that they cut their prices in the past year, while only 23% raised them.

Meanwhile, Mr Gross's thesis has begun to be tested by the Fed, which has raised interest rates six times since the middle of 2004. So far, the sky has not fallen in. Stockmarket valuations imply that investors, probably sensibly, expect the profits of American financial firms to grow by less than 2% a year over the next five years, reckons UBS, compared with 14% annual growth for information-technology firms and 10% growth for industrial firms.

At some point, overall profit growth is bound to slow down. Unit labour costs will rise as wages improve and productivity growth slows. (Productivity growth already seems to be slowing a bit in America.) Alternatively, the naturally buoyant spirits of corporate book-keepers will eventually catch up with them, and firms will make another round of massive write-offs—laying the ground for another few years of booming profits.

Energy in Africa

To Libya and beyond

Feb 10th 2005 | JOHANNESBURG
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Oil and gas firms are busy in Africa

Reuters

Oil man, not evil man

"THIS is good news for Libya, of course!" exclaims Mohamed Sulaiman, a businessman in Tripoli, Libya's capital. Mr Sulaiman monitors the arrival of foreign investment in his country and is increasingly busy. Last week the government announced the winners of the latest round of bids for oil exploration. American oil firms, especially, are piling in. Three—Occidental, Amerada Hess, ChevronTexaco—won 11 of 15 contracts up for grabs. Eager for a foothold after an absence of two decades—due to American sanctions lifted last year after Libya's ruler, Muammar Qaddafi (pictured), quit the axis of evil—they evidently outbid their already established European rivals.

Mr Sulaiman is no longer surprised to meet American businessmen, especially oil men. "We want friendship, we don't hate any foreigners," he says. Libya produces 1.6m barrels of oil a day, but with foreign help hopes to lift that to 2.1m in five years. The government will probably launch another round of bids for exploration contracts in a few months.

Libya's experience is being repeated across much of the continent, with most activity in two big fields in north Africa and west Africa's Gulf of Guinea, which together may contain 100 billion barrels of oil, plus huge quantities of gas, estimates Jeff Waterous, a consultant active in Africa.

American interest is both commercial and strategic. Firms once barred from Libya, and still blocked by sanctions from Sudan (which plans to triple oil output to 1m barrels per day within a few years), sought supply elsewhere on the continent. Africa provides roughly 15% of America's oil imports—a share that will surely rise as firms seek more reserves outside the risky Middle East. New discoveries are drawing others to Africa: American military and business activity rose notably in São Tomé e Príncipe on news of estimates of billions of barrels of oil there.

Big established producers, such as Nigeria and Angola, also expect to increase production. Mauritania, Nigeria and Angola each plan big increases in gas exports. Last year Henry Aldorf of Marathon Oil, an American firm, set out plans to tap Equatorial Guinea's estimated 5.5 trillion cubic feet (156 billion cubic metres) of gas, plus supplies piped by neighbouring countries. In 2007 his firm will open a big liquid-natural-gas storage plant in Malabo, the capital, to meet growing demand from America.

Not all foreign investors are welcome. Last year some 70 British and South African mercenaries were convicted of plotting a coup in Equatorial Guinea. Prosecutors said that the coup-financiers, mostly based in London, put up a reported $3m, expecting to profit by controlling oil contracts.

Last month in South Africa Mark Thatcher, the son of Britain's ex-prime minister Lady Thatcher, pleaded guilty to having played a minor part in the plot. The coup failed, but outsiders' interest in the oil in Equatorial Guinea—and the rest of Africa—shows no sign of abating.

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Face value

Chief humanising officer

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Richard Scoble

Does Robert Scoble, a celebrity blogger on Microsoft's payroll, herald the death of traditional public relations?

ROBERT SCOBLE, known in the blogosphere as “the Scobleizer”, is a phenomenon not just because he has had an unusually strange career of late, but because his example might mark the beginning of the end of “corporate communications” as we know it. Mr Scoble is, first, a blogger—ie, somebody who keeps an online journal (called a “web log” or “blog”) to which he posts thoughts and web links several times a day. But Mr Scoble is also an employee of Microsoft, the world's largest software company, where he holds the official title of “technical evangelist”. Those two roles are intertwined. It was his blogging prowess that led to his job, and much of the job consists of blogging.

Mr Scoble seems to be worth his salary. He has become a minor celebrity among geeks worldwide, who read his blog religiously. Impressively, he has also succeeded where small armies of more conventional public-relations types have been failing abjectly for years: he has made Microsoft, with its history of monopolistic bullying, appear marginally but noticeably less evil to the outside world, and especially to the independent software developers that are his core audience. Bosses and PR people at other companies are taking note.

Mr Scoble started blogging four years ago. At the time, he worked for NEC, a Japanese technology company, and was based in Silicon Valley, a place rife with loathing for Microsoft. Mr Scoble's area of expertise was tablet PCs—laptop computers that allow users to handwrite their notes, and that

have been mostly a dud, both then and now. But Mr Scoble used his blog to converse with NEC's customers, giving tech support and listening to feedback, with such disarming honesty that his blog became a must-read for gadget lovers.

This caught the attention of Lenn Pryor, who is—really—Microsoft's “director of platform evangelism”. Until then, says Mr Pryor, Microsoft had been evangelising mostly one-on-one, “which doesn't scale well”. But Mr Pryor had a radical idea. Afraid of flying, he had met a pilot at United Airlines who told him to tune into channel nine from his plane seat, where he could listen in on the communications of the pilots. Mr Pryor did, and soon “the irrational nature of my fear started to fade”. It had something to do with hearing real people talking honestly. He realised that Microsoft, the target of similarly irrational fears, should have its own version of channel nine, and that public blogging by insiders should be an important part of it.

Mr Pryor figured that the straight-talking Mr Scoble would make a reassuring pilot or “a great evangelist”. So he hired him. Mr Scoble, for his part, simply kept doing what he was good at. His blog—which he has kept outside of Microsoft's computers, and to which he usually posts in the wee hours after midnight—reads like a stream of consciousness. A reader might discover, for instance, that Mr Scoble's new wife just became an American citizen, or how to win a cheese contest. “A good blog lets you see the mess; lets you see behind the scenes,” he writes in one entry.

But Mr Scoble is at his best when he opines ruthlessly on Microsoft's technology. When Google or Apple or anybody else makes a better product, he blogs it. “I've been pretty harsh on Microsoft over the years,” he says. This gives him credibility, and thus power. If somebody somewhere takes a swipe at Microsoft that is unfair, Mr Scoble can cry foul and actually have his readers concede the point.

Inspired in part by Mr Scoble's success, executives at other companies—so far, mostly in tech—are starting their own blogs. Most daringly, Jonathan Schwartz, number two at Sun Microsystems, a large computer-maker, has blogged his thoughts about possible mergers in his industry, and thrown punches at Hewlett-Packard, IBM and other rivals. Bruce Lowry, PR boss at Novell, another software firm, also wants to get his executives blogging. Boring old press releases—where everybody is constantly resigning “to spend more time with the family” and what not—are totally ill-suited for responding to most PR issues, such as rumours or independent commentary, he says. He can imagine blogs completely replacing press releases within ten years.

As easy as falling off a blog

Mr Scoble himself is careful to make no such sweeping predictions. He thinks that there will always be a place for traditional PR, with its centrally controlled corporate message, alongside the spontaneous cacophony of blogs. Microsoft's official PR boss will not even comment at all on the subject. Sun's Mr Schwartz is also circumspect. “It's not the end of PR but the end of the old PR department,” he says. “The clarifying force will be credibility and reputation.” The truth is, nobody yet knows how corporate blogging will evolve.

This caveat is especially important because it is probably “only a matter of time” before a serious blogging embarrassment leads to litigation, says Joseph Grundfest, a professor at Stanford Law School and a former commissioner at the Securities and Exchange Commission. As with e-mail, but perhaps more so, “people blogging get taken in by the immediacy and the hotness of the medium and say things they later regret,” he says. This fear is now prompting internal compliance lawyers to cast an eye on their firm's bloggers.

This suggests another possible development. Will corporate bloggers start to get tongue-tied and

sound just like tedious press releases? Mr Scoble, for his part, hates the question but concedes that, theoretically, Microsoft's corporate view and his own could come into severe conflict, and it is not clear what would happen then. Will he criticise only the small things, but toe the line on the big issues? As his page views, fame and influence increase, it might become increasingly difficult for him not to feel self-conscious, and to resist the deadening effect that this can have on any writer's prose.

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Nokia's turnaround

The giant in the palm of your hand

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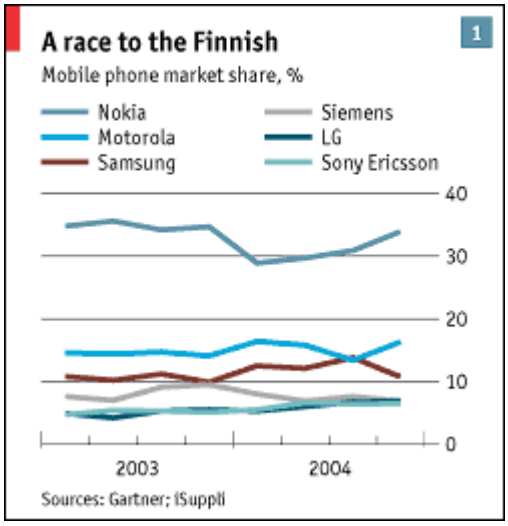
Can Nokia, the world's largest handset-maker, stay on top?

ITS products may be diminutive, but that is not an adjective anyone would apply to Nokia itself, the Finnish company that is the world's leading maker of mobile phones. With annual revenues exceeding €29 billion ($36 billion), it is also the largest vendor of telecoms equipment on earth. The mainstay of its business is mobile phones, around 650m of which were sold last year, over 200m of them made by Nokia. Given the complexity of modern handsets, that means that Nokia is arguably the world's leading computer-maker, too. And given the spread of camera-phones, which account for nearly half of all mobile phones sold, Nokia is, by some estimates, the world's leading camera-maker as well. With hundreds of components going into each handset, Nokia manages an extraordinarily efficient logistics chain that handles over 60 billion components a year. Everything about the company—except its products—is big.

Last year, the giant stumbled. In April Nokia unexpectedly warned that sales had slowed in the first quarter of the year, all the more surprising after its record results of the previous three months. Nokia's shares lost over half their value between March and August, and its market share, having hovered around 35% for years, fell to a five-year low of 28.9% in the first quarter of 2004, according to Gartner, a consultancy (see chart 1).

Nokia took drastic action, and has since reversed the decline in its market share. Announcing the company's annual results on January 27th, Jorma Ollila, Nokia's chairman and chief executive, described 2004 as “demanding”, but insisted that his firm was now well positioned to compete in an increasingly tough industry.

Most observers, however, believe it is still unclear whether Nokia has recovered its stride. The firm “has yet to provide convincing data that it has turned the corner,” says Per Lindberg, an analyst at Dresdner Kleinwort Wasserstein. Even more optimistic observers, such as Ben Wood, an analyst at Gartner, concede that, having stabilised its position, Nokia must now solidify it. In particular, says Mr Wood, “they are going to have to pull some fantastic products out of the hat,” at the industry's annual 3GSM conference, which takes place in Cannes next week.



The conventional wisdom has it that Nokia's troubles last year had a lot to do with its failure to anticipate the popularity of flip-phone or “clamshell” handsets, which are particularly popular in Asia and North America. Nokia was the first handset-maker to realise that mobile phones were becoming fashion items, and to place a heavy emphasis on design. Such savvy helped to propel it to the top of the industry in the 1990s. Another big factor was the rise of GSM, a mobile-phone technology that was adopted as a European standard to ensure smooth roaming from one country to another. Having collaborated on the Nordic Mobile Telephony network during the 1980s, Scandinavian vendors understood the challenges involved in implementing GSM. As the technology emerged as the dominant global standard, Ericsson of Sweden became the leading maker of network gear, and Nokia took the lead in handsets, displacing Motorola.

Yet now it is a Motorola clamshell phone, the RAZR V3, that critics hold up as evidence that Nokia has lost its edge in design. The RAZR, a silver sliver of a handset with a stylish aluminium shell, is the phone to be seen with at the moment. Nokia's line-up looks staid by comparison. The firm has long favoured “monobloc” or “candy bar” phones that do not fold, and grudgingly introduced its first clamshells only last year, to mixed reviews.

“We definitely had gaps in our product portfolio,” admits Olli-Pekka Kallasvuo, head of Nokia's mass-market handsets division. Under Ed Zander, its new boss, Motorola suddenly remembered how to make good handsets. And the three leading Asian vendors, Samsung and LG of South Korea and Sony Ericsson (a joint-venture between Sony, of Japan, and Ericsson) also had impressive products. Nokia was, Mr Ollila admits, vulnerable particularly in the mid-range, and was unable to capitalise as consumers in Europe upgraded to new handsets with colour screens and cameras. But it was not simply the lack of clamshells, says Carolina Milanesi of Gartner: “The portfolio was missing the edge it had before.” Does the fate of mobile-phone giants really hinge on such apparently frivolous matters?

Calling the shots

In fact, losing its edge in handset design was one of three problems that caused Nokia to stumble last year. The design weakness occurred just as mobile operators were becoming keener on operator-specific, customised handsets. That presented Nokia with a second challenge, says Mr Ollila. To increase their brand differentiation, operators in Europe and America were striking deals, usually with smaller Asian handset-vendors or contract manufacturers, to provide their own handsets. Vodafone, for example, the world's largest mobile operator, launched its “Vodafone live!” data service using handsets supplied by Sharp, a Japanese firm. And several operators sell handsets made by HTC, an “original design manufacturer” (ODM) based in Taiwan, under their own brands. Even Motorola got in on the act, making a special version of one of its handsets for Vodafone. Operator-specific handsets are usually locked to prevent them being used on another

operator's network, boosting customer loyalty and promoting the operator's brand at the expense of handset-makers' brands.

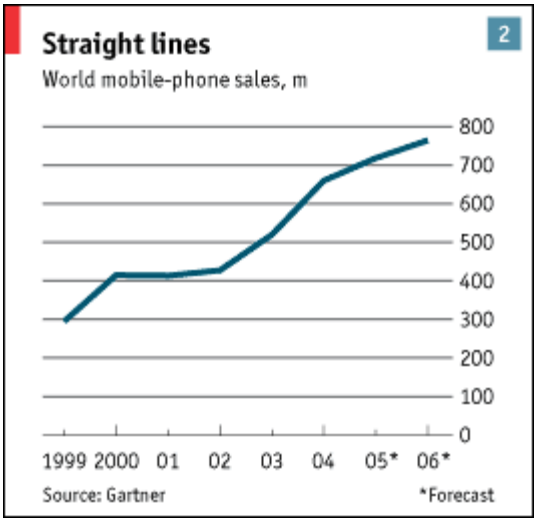
The big loser in all of this was Nokia. As the leading handset-maker with the strongest brand it has been disinclined to yield to the demands of operators. Indeed, it regards end users as its customers, even though they usually buy their handsets through operators. Nokia's attitude is understandable: in Europe, where switching between operators is easy, most consumers are more loyal to handset-makers.

But other handset-makers were prepared to go along with the operators in return for a boost in market share. There was, in effect, an unspoken agreement between the operators and smaller handset-makers to take Nokia down a peg or two. According to the boss of one large operator, Nokia became complacent and forgot that it had to keep its real customers, the operators, happy. “I said to them, ‘Remember who writes you the cheques',” he says.

The third factor behind Nokia's stumble was an internal reorganisation that took place in late 2003, creating separate units for mass-market, business and multimedia phones. This made sense strategically, but the reshuffle caused Nokia to take its eye off the ball. Mr Ollila concedes that, with hindsight, the timing of the reorganisation was somewhat unfortunate. But he insists that it was still the right thing to do. Indeed, Motorola instituted a similar reorganisation a year later.

Having realised things were amiss, Nokia responded quickly. It cut prices on selected handsets to reclaim market share, albeit at the cost of lower margins. It also adjusted its portfolio, killing off some handsets and advancing the launch of others, including several with clamshell designs. Two handsets in particular, the low-end Nokia 1100 for emerging markets and the Nokia 6230 mid-range camera-phone, emerged as “hero products” during 2004, says Mr Kallasvuo. The latter model, a monobloc design, was so popular that Nokia was at times unable to meet demand. Clearly, a clamshell design is not a prerequisite for success.

The overhaul of Nokia's handset range is still under way and will take until the end of 2005, says Mr Kallasvuo. New models are promised based on novel materials such as velvet and rubber: there is plenty of scope, he says, to use new materials in industrial design. And a range of art-deco-styled fashion phones, launched in September, shows that Nokia can still be daring: one model even does away with the keypad, in favour of an iPod-style navigation wheel. “It's innovative, but it's niche,” says Ms Milanesi. Nokia will launch 40 new handsets this year, including several in Cannes next week.



Perhaps most significantly, but least visibly so far, Nokia also changed its tune on operator customisation. “The last year has taught Nokia a few things,” says Brian Modoff, an analyst at Deutsche Bank. Despite the firm's historical reluctance to produce operator-specific handsets, he says, “they are not about to start leaving market share on the table”.

Nokia executives insist that the company's apparently belated enthusiasm for customised handsets was, in fact, the result of technical factors. Given the volume of handsets that Nokia sells and its reliance on scale, says Mr Ollila, it was not feasible to make different handsets for individual operators without a reorganisation of its logistics chain. Instead, Nokia's preference is to customise handsets through software rather than hardware modifications. In particular, Nokia's

Series 60 software, which powers its high-end phones, is highly configurable, so that the same hardware can support different operators' news, music and gaming services, simply by making changes to its software at the last minute.

Chain reaction

The next step, says Mr Kallasvuo, will be to move into hardware customisation too, where volumes justify it. This has involved making changes to Nokia's logistics chain that it once resisted. But Nokia's closer co-operation with operators, says Mr Ollila, paid off in its market share in the last three months of 2004, which rebounded to its 2002-03 levels. Margins also improved in the second half of the year. Hence Mr Ollila's optimism that Nokia is now, after a difficult year, well positioned to face the many challenges that lie ahead in the mobile-telecoms industry.

For a start, there is the industry's increasing volatility. New competitors from Japan and South Korea, and ODMs from Taiwan, have marched on to Nokia's European home turf. Samsung and Motorola are locked in a fierce battle for the industry's number two position. Siemens, the unprofitable number four, seems poised to leave the industry, probably by selling out to an Asian vendor, suggests Mr Lindberg. Market shares are in constant flux. LG is quietly exploiting the confusion by growing faster than any other vendor, albeit from a low base. Mr Modoff describes the situation as a “soup du jour”: “Today one brand is hot, and tomorrow it's leftovers,” he says. Intense competition has shortened product lifetimes to six or nine months, giving handset-makers less time to ramp up volumes and exploit their most popular models before fashion moves on.

Nokia's response to all of this is to exploit its unrivalled scale, which allows it to operate on a completely different model from the rest of the industry. The company does nearly all its manufacturing in-house, designs its own radio chips, is far more vertically integrated than its rivals and has unrivalled prowess in logistics. Mr Modoff likens its operational excellence to that of Dell or Cisco; if only it had the products to match, he grumbles. The best way to fend off the ODMs, believes Mr Ollila, is through higher volumes and lower prices. Shorter product cycles, meanwhile, play to Nokia's hand, since it has the most efficient supply chain and distribution. And the switch to third-generation (3G) networks, which demand more complex handsets, also favours Nokia, says Mr Ollila, since its smaller rivals cannot compete in research and development.

Second-mover advantage?

That is debatable, however. The leading vendor of 3G handsets in Europe at the moment is LG which, unlike Nokia, does not make its own radio “baseband” chips (a crucial component of a mobile phone), but simply buys them from Ericsson and Qualcomm. For all its technological expertise, Nokia has only two 3G handsets in its line-up, neither of which supports videotelephony—supposedly a key feature of 3G. Indeed, compared with its rivals, Nokia has been horribly late in bringing 3G handsets to market, though they will account for ten of the 40 new models the company will launch this year. Might Nokia lose its dominance amid the switch to 3G, just as Motorola did in the switch to 2G? Possibly. “There weren't many Asian vendors around when GSM first evolved,” says Mr Modoff. “But with 3G, Samsung, Sharp and LG are right there with them.”

Mr Ollila responds that it is still early days for 3G handsets and it is better to get things right than be the first to market. “Being first is not necessarily a gateway to heaven,” he says. He has a point: early 3G phones from other handset-makers were temperamental plastic bricks, and the clear lesson from Japan, a testbed for 3G since 2001, is that consumers will buy 3G handsets only when they are as small and reliable as 2G ones. “Being first is very painful,” says Ms Milanesi. “You go through a lot of ugly ducklings.” In Europe, 3G handset sales are expected to take off

from 2006, so Nokia has time to get its product line-up ready in the coming months. By the fourth quarter of 2005, Mr Ollila predicts, “we will see some quite different market-share numbers” in 3G handsets.

But Nokia faces another big challenge: identifying new sources of growth. One obvious bright spot is the developing world, where subscriber growth is still healthy. Nokia is doing well selling low-end handsets in emerging markets such as India, China, Russia and Latin America. In the saturated markets of the developed world, in contrast, handset-makers must convince subscribers to upgrade their existing handsets by luring them with snazzy design and whizzy new features. Nokia has no shortage of ideas.

Phones for business users are regarded as a particularly promising area. “We think it's probably the single largest untapped market for Nokia,” says Mary McDowell, head of Nokia's enterprise solutions group, who joined the firm from Hewlett-Packard last year. Ms McDowell's team is based in New York in order to be close to Wall Street firms, which tend to be the leading adopters of new technologies (such as the BlackBerry e-mail device made by RIM of Canada). Nokia has licensed the BlackBerry software for use on its handsets, along with similar software made by Visto and Good Technology. “Our goal is to be the preferred device for corporate e-mail,” says Ms McDowell. Fewer than 10% of office workers have mobile e-mail, so there is plenty of room for growth, she says. Corporate buyers insist on devices that are secure and can be remotely managed. But that plays to Nokia's strengths: it already sells a range of network-security appliances.

Consumer multimedia, including games and music, is another area of focus. But Nokia's attempts in this area have not gone well so far. The N-Gage, a hybrid gaming device and mobile phone launched in 2003, has sold poorly and now faces stiff competition from the Sony PSP and Nintendo DS. That said, the quality of N-Gage games has improved and Nokia has denied rumours that it is about to kill the N-Gage off. But its appeal appears limited to a small niche. Similarly, Nokia has led the way in promoting mobile television, based on the new DVB-H standard. But it is too early to tell either if operators are prepared to make the necessary investment, or if consumers will pay to watch television while on the move.

What about mobile music, the latest fad being talked up by the industry? Motorola has developed a handset compatible with Apple's iTunes software, while Nokia has yet to announce a music phone, notes Ms Milanesi. Watch this space, Nokia executives reply. Unlike its rivals, claims Mr Kallasvuo, the company prefers not to trumpet products months before they reach the market.

The nightmare scenario

Nokia is clearly committed to its traditional strategy, based on maintaining a large market share and the economies of scale which both accompany and support such a share. The firm could have changed direction last year and focused more, say, on higher-margin products. But it chose not to. Should it have? Mr Lindberg believes that Nokia cannot stay on top indefinitely. He predicts that its market share will fall to 22% by the end of 2007, with Sony Ericsson and LG the main beneficiaries. If he is right, Nokia will lose its scale advantage, and will no longer be able to play by its own rules.

Nokia is, say critics, being pushed downmarket as its share of revenue declines and it becomes more reliant on low-end handsets. But, says Mr Kallasvuo, “being strong at the low end does not preclude strength at the high end.” Nokia's breadth and agility enables it to ride out fluctuations in geographical demand and product mix. And its efficiency makes it very difficult for rivals to challenge it at the low end, says Mr Modoff. Chinese manufacturers that have tried to undercut Nokia have had their fingers burned.

Mr Lindberg believes that Nokia's fate is to end up as “a leader in handsets, but not the leader”, and that it should start preparing for this eventuality now. It should raise its prices to rebuild its brand, he suggests, and rely more on external suppliers, including ODMs, to design and build its handsets, as its rivals do.

If Nokia's managers are even entertaining the thought of such a heretical fall-back plan, they are keeping quiet about it. “I don't believe in that theory,” says Mr Kallasvuo, when asked if Nokia's reliance on scale, historically a strength, could turn into a vulnerability. The notion that big is beautiful remains the core of the company's strategy. Will it keep Nokia on top? Mr Ollila replies without hesitation: “Absolutely,” he says. “Absolutely.”

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The G7, aid and debt

They have willed the ends, but what about the means?

Feb 10th 2005
From The Economist print edition

Reuters

Finance ministers display generosity and some ingenuity, but little unity

TO MANY churchgoers, the forgiveness of sin is a simple business: confess; be heartily sorry; receive absolution; do penance. The many Christians who rallied to the Jubilee 2000 campaign hoped that the forgiveness of poor countries' past debts would be similarly straightforward—easier, indeed: were the poor not innocent? Sovereign debts, they said, should simply be wiped out.

Five years after the campaign's deadline, many poor countries are still burdened. The 38 heavily indebted poor countries (HIPCs), most of them African, owe money not to rich nations, most of which have cancelled their bilateral debts, but to multilateral institutions, such as the World Bank, the International Monetary Fund (IMF) and the African Development Bank (ADB). On February 5th the HIPCs were given hope. Finance ministers of the Group of Seven rich countries, meeting in London, said that “as much as” 100% of their multilateral debts should be forgiven.

An initiative to relieve the HIPCs' debts has been running since 1996. This has more than halved the debts owed by 27 countries, at a cost of $10.8 billion to the World Bank, $5.2 billion to the IMF and $3.9 billion to the ADB. But the Fund and the Bank are wary of going all the way. A bank's loans, after all, are its chief asset. In the past, the Bank and the Fund have given warning that a 100% write-off would “imperil” the Bank, “impair” the Fund and “cripple” the ADB.

To reassure the World Bank and its African counterpart, the British government has offered to service 10% of the debts that poor countries owe them. Britain has called on other rich countries to do their share. America, however, believes the Bank's money is all but irretrievable. It

discounts its own loans to such heavily indebted countries by 92%. By writing off its loans, the Americans argue, the Bank is not forfeiting a return, but facing reality.

Some believe that after the latest round of debt relief the World Bank should get out of lending altogether and concentrate on giving instead. Allan Meltzer, an economist at Carnegie Mellon University, made just such a recommendation several years ago in an influential report for America's Congress. He has found some sympathetic ears in the Bush administration. The Bank, however, thinks that a cycle of begging for funds from rich nations, then giving them away, would be devastating to its financial independence.

In principle, dollars will go further if they are lent rather than given away: money that is repaid, after all, can be relent. But in practice the Bank's soft loans do not revolve in this way. By July 2005, it will have made available about $23 billion in such loans over three years. Only about $4 billion of this is drawn from repayments of past soft loans. “Whether recycled or forgiven, loans are simply grants in disguise,” Mr Meltzer claims.

He argues that the Bank's loans revolve, not from one country to another, but from one country and then back again. The Bank is trapped into defensive lending, he says, offering new loans to stave off default on old ones. Writing off these debts will, it is hoped, free the Bank from this damaging cycle, allowing it to put its money, whether in the form of grants or loans, where it would do most good.

Searching for a pot of gold

The G7's final communiqué said that debt relief should not eat into the aid budgets of the Bank and the ADB. The IMF, however, may have to pay its own way. It has been asked to look to its vast holdings of gold, which weigh in at 103.4m ounces. This hoard is a relic of the Bretton Woods era, when the dollar was tied to gold and the metal was used to settle transactions between the Fund and its members. The gold sat, largely unused and grossly undervalued, on the balance sheet until almost 13m ounces were sold in 1999 and 2000 to help finance the Fund's contribution to the HIPC initiative. The IMF may be asked to sell more or to revalue its gold, boosting the asset's book value and thus creating room on its balance sheet to write off debt.

The need to find more money does not end there. To meet the ambitious United Nations development goals that world leaders set for themselves at the turn of the millennium, rich-world governments will need to hand out more aid and undertake an “ambitious replenishment” of the World Bank's coffers, as the communiqué put it. Awkwardly, most G7 governments already have big holes in their budgets. Hence the discussion at the finance ministers' meeting and in the weeks before it of new sources of revenue. According to Jean-Claude Juncker, head of the European Council of finance ministers, most European finance ministers now support the idea of an international tax on aviation fuel. The idea was proposed in December by Jean-Pierre Landau, a French civil servant commissioned by Jacques Chirac, France's president, to find new sources of money for development.

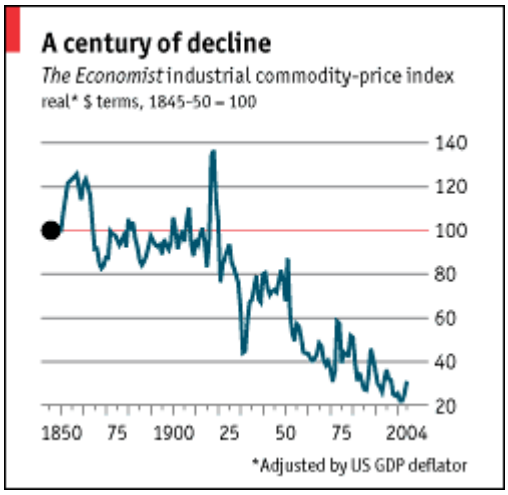
Mr Landau explored several options, including a “Tobin tax” on cross-border financial transactions or even a worldwide lottery. A levy on aviation fuel would close an unjustifiable loophole—why should air travel be exempt from the fuel taxes that road and rail must pay?—and put a price on the pollutants and emissions associated with air travel. A fuel tax, unlike a Tobin tax, would also be difficult to avoid, even if levied only in Europe. However, there is no obvious connection with development; governments might be tempted to cut other sources of aid money; and airlines are struggling. In their rush to redeem indebted nations, the Europeans may damn some indebted airlines.

The Economist's commodity-price index

160 years on

Feb 10th 2005
From The Economist print edition

It is time to rebase our commodity-price index



FIRST published in 1864, with figures stretching back to 1845, *The Economist*'s commodity-price index is probably the world's oldest regularly published price index. Since October 2001, our dollar-based industrials index has risen by 76%, fuelled by Chinese demand for raw materials and, in part, the weakness of the dollar. Yet in real terms, industrial commodity prices are a mere 30% of their value in 1845 (see chart).

Over the years our index, published among our economic indicators each week (see article), has been revised many times, with new commodities being added and others dropping out. This week it has again been rebased. The index now takes 2000, not 1995, as the base year and the weights for each commodity are based on the value of world imports in 1999-2001 (treating the European Union as a single market). The index, made up of 25 commodities, excludes oil and precious metals.

Foods now account for 56% of the all-items index, slightly down from before, while the share of industrials has risen to 44%. Wheat and coffee still have the biggest weights in the food index. But thanks to falling prices, sugar now accounts for only 6.6%, half its previous weight. Aluminium makes up almost half of the metals index. Here are the new weights and back figures (monthly and quarterly) for the indices.

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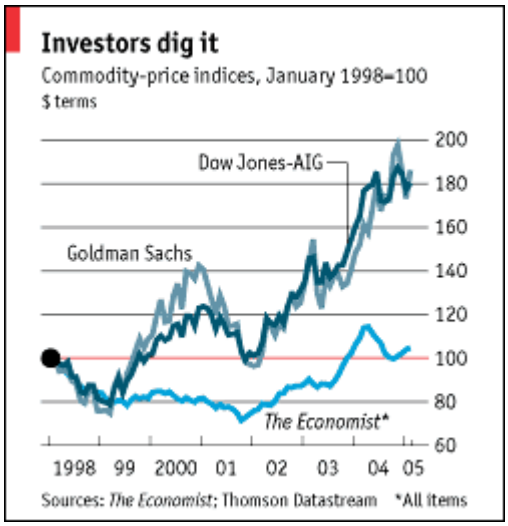
Commodities

A certain shine

Feb 10th 2005
From The Economist print edition

Have investors embraced commodities too late?

IN THE business world, the word “commodity” has become something of an insult—a synonym for “boring”, when applied to products, or “easily replaced” when speaking of people's skills. Lately, commodities have been neither. Last year's soaring prices of oil and gold—the former to over $50 a barrel, the latter to more than $450 an ounce—are just the most visible examples of how really exciting commodities can be.



The prices of plenty of other commodities have been climbing too. Base metals, such as copper and aluminium, have enjoyed a bull run, fetching their highest prices for many years. Some “soft” commodities, such as coffee and rice, have also seen gains. Broad indices of commodity prices used by investors, which unlike *The Economist*'s index (see article) include prices for energy and precious metals, reached record levels in the autumn.

To some extent, the rise in commodity prices during the past three years can be attributed to the raging appetite of the Chinese economy. China's imports of copper and alumina are the biggest in the world. Its oil imports are now second only to America's and it is the biggest buyer of American soyabeans. But China is not the only reason: last year the world economy grew at its fastest for almost three decades.

The weakness of the dollar, in which nearly all commodity prices are quoted, has exaggerated the boom. In euros or yen, price increases have been less impressive. For example, Goldman Sachs's commodity-price index rose by 17% in dollar terms during 2004. In euro terms, the gain was 10%. But that is an appreciable increase nonetheless; and as well as climbing, commodity prices have been more volatile than in the quiet 1990s.

Has the boom now reached its peak? The two most popular indices used by investors, the Dow Jones-AIG Commodity Index and the Goldman Sachs Commodity Index, have fallen by around 10% in recent months (see chart). This is partly explained by expectations of a cooling global economy and of a slowdown in China in particular—although the country's fourth-quarter figures, which were stronger than expected, gave commodity bulls renewed hope. Another reason is that output is expected to rise to match demand for the priciest metals.

Although the prices of many commodities, notably oil, have slipped back below their recent peaks, investors of all types have more at stake than ever. At the end of 2002, reckons Barclays Capital,

only $278m was invested in American mutual funds tracking a commodity index. By last August, that had risen to $6 billion. One of the biggest such funds, PIMCO's Commodity Real Return Strategy fund, has seen assets grow four-fold.

Once, the main way of benefiting from commodities was buying shares in mining companies. Now commodity-trading advisers, funds that invest in clever commodity strategies, are gaining in popularity. Some investors have made highly specific choices: for instance, the managers of Harvard University's endowment have bet on timber. Others are intrigued by the opening of new markets for commodities such as plastics and carbon emissions.

Fund managers can point to good reasons for the flood of money into commodities. Whether prices go up or down, returns do not fluctuate in line with those of shares and bonds. That can make commodities especially useful in making a portfolio less volatile. Moreover, they can often serve as a hedge against inflation.

Whatever fund managers say, however, for most investors rising prices are likely to be commodities' most seductive trait. Yet commodity prices have a long history of running in cycles. As demand rises, so do prices, because supply takes time to respond. When new supply arrives—often, too much of it—prices tumble. If the cycle is indeed turning down, investors' affections may fade fast.

One sure sign that an asset class has hit the mainstream is the marketing of fancy derivatives. In December, Barclays Capital launched something called a Collateralised Commodity Obligation (CCO). Many investors, accustomed to the calmer bond markets, have been wary of the racier world of commodities. The CCO gives them a chance to earn a steady, bond-like payout but with a higher yield, thanks to its exposure to commodities. The repayment of principal, however, depends on the prices of dozens of commodities at maturity. No one can call that boring.

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Euronext and the LSE

Priceless

Feb 10th 2005
From The Economist print edition

An approach to the London Stock Exchange is missing one detail

Bloomberg News

Théodore has his eyes on London

AT LAST, the London Stock Exchange (LSE) has the competing proposals for its hand in writing. On February 9th Euronext, operator of several continental exchanges, published details of its case for bringing the LSE into its fold. Euronext promised that trading would get cheaper and said that a takeover would yield €203m ($260m) annually, through lower costs and higher revenue. However, unlike Frankfurt-based Deutsche Börse, which opened the battle for the LSE, Euronext put forward no price tag. Deutsche Börse's £1.35 billion ($2.4 billion) offer, made in December and repeated late last month, was roundly rejected.

The LSE's board made no comment on the new proposal, citing (understandably) the absence of a price. That detail aside, in many respects Euronext's intentions look similar to Deutsche Börse's. Both say that the LSE's customers will enjoy a 10% cut in trading costs. Neither Jean-François Théodore, boss of Euronext, nor Werner Seifert of Deutsche Börse seems willing to move the headquarters of a combined exchange to London. But both brim with assurances that regulation of the LSE will be unchanged, since Britain's Financial Services Authority (FSA) is doing such a fine job. Euronext, which sees itself being dually listed in London and Paris, says it would adopt a single-tier board for the combined exchange; Deutsche Börse is bound to a two-tier model by German law.

The bids differ strikingly, however, in their calculations of the benefits of a merger: €203m a year before tax, says Euronext; a mere €100m, reckon the Germans. But they are banking on the same sorts of improvements: cost savings from merging trading systems, better distribution networks

and so on. Quite why Euronext should be able to promise so much more is hard to see—although it will be able to capitalise on its foothold in London, having bought Liffe, the London derivatives market, three years ago. Euronext puts restructuring costs at €184m, nearly twice Deutsche Börse's estimate.

Ultimately the battle may turn not just on numbers, but on corporate governance and regulation. Last week the FSA warned that while it was “indifferent to the nationality” of a combined exchange, long-term regulatory arrangements deserved more thought. Even if the LSE stays under the watch of the FSA for some years after being bought, future electronic improvements could mean that LSE traders end up sending orders to a market elsewhere, under another regulator. Moving a combined exchange's headquarters to London would assuage such concerns.

If Deutsche Börse's experience is any guide, Euronext may encounter some skittishness from shareholders, who will want to know how much they would pay for the LSE. At least one Deutsche Börse shareholder is demanding a meeting to vote on whether a takeover bid is even sensible. Euronext is required by Dutch law to hold such a meeting. Though listed in Paris, it is registered in Amsterdam.

As talks continue all round, the LSE is meanwhile doing nicely on its own. The same day as receiving Euronext's proposal, the London exchange announced that January 2005 had been its busiest month ever, with trading on its main platform up by 17% from a year earlier. That will make its two admirers even keener.

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Investing in Russia

Forgive and forget?

Feb 10th 2005 | MOSCOW
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The meanings of a Russian IPO

TWO stories, happy and gloomy, are told about the Russian economy. At first glance, a big initial public offering (IPO) in London on February 9th by Sistema, a Russian conglomerate, suggests that investors have decided to believe the happy one.

The optimistic narrative involves broadly sound macroeconomic policy, with growth of 7.1% last year (according to the government, at least); investment-grade credit ratings from all the main agencies; and plans to rein in tax officials. The gloomy version involves corruption, stalled reforms and the ongoing saga of Yukos, once the country's biggest oil company, crippled by enormous tax demands and the arrest of its boss, Mikhail Khodorkovsky. Menatep, Yukos's majority owner, this week sued Russia's government, claiming $28.3 billion in damages. Mystery still surrounds the forced purchase of Yukos's main production arm.

Sistema sold 16.5% of its stock to institutional investors at a price that implied a total capitalisation of $8.2 billion. The price rose a little on the day of flotation. It is tempting to conclude that this success marks the eclipse, in investors' minds, of the scary story by the brighter one. It doesn't, and shouldn't, for two reasons.

The first is simply that global conditions are favourable. A lot of cash is looking for a half-decent yield—and is thus heading for emerging markets. The second concerns the peculiarities of the Russian market. Sistema bills itself as a diversified holding company, with interests in electronics, retail, property, banking and insurance. In fact, virtually all its profit comes from its controlling stake in MTS, a big mobile-phone operator. Mobile-phone subscriptions are rising fast. Sistema is also expected to be a bidder in the privatisation, supposedly forthcoming, of Svyazinvest, a state-controlled telecoms firm. Telecoms carry less political risk than natural resources, which dominate Russian stocks.

That said, there is some danger. Vladimir Yevtushenkov, who even after the IPO will own 65% of Sistema, is close to Yuri Luzhkov, the mayor of Moscow; and one day a new mayor might come along. Still, the risk of that happening soon seems relatively low. So Sistema offers a safe entry to a growing emerging economy, in which few attractive stocks float freely.

This week's offer was said to be more than twice oversubscribed. That, says Chris Weafer of Alfa Bank in Moscow, does not suggest an especially frantic scramble. Still, it does seem that people are willing to get back into Russia, at the right price. Other Russian owner-managers are likely to cash in now that Sistema has tested the water. Besides supplying capital, foreign investors can help to fend off bureaucratic attacks—although not always (just ask Mr Khodorkovsky, still in jail). For the moment, like jilted but still-keen suitors, investors are eyeing Russia longingly. Having been hurt before, they are not quite sure whether to approach.

European bonds

The market and Methuselah

Feb 10th 2005
From The Economist print edition

Governments in Europe are thinking of borrowing longer

AS EUROPE ages, investors are looking around for trouble-free investments to keep them in their increasingly long sunset years. A couple of European governments are thinking of giving them just that. In December, Britain's Treasury floated the notion of issuing 50-year bonds. The response of pension funds and insurance companies was, broadly, a bowler-hatted cheer. This month, France's treasury commissioned a group of banks to find out whether a 50-year bond in euros would go down well.

Though neither government has made up its mind, Britain could announce a sterling-denominated Methuselah when it reveals its funding strategy for the year, probably next month. The betting among bankers in Paris is that France's 50-year bond will go ahead, perhaps as soon as March. Germany is watching the French decision beadily, while Italy has already expressed interest.

This looks like a meeting of minds. Governments want to borrow as cheaply as possible, and would like to lock in today's low long-term rates for half a century. On the other side, pension funds, life-assurance companies and others that have liabilities stretching out into the future need assets that can provide a discountable income stream to match them. Britain, with its tradition of funded pension schemes, has always issued long bonds: just under 16% of outstanding gilts mature in 25 years or more. In the euro-zone market, however, fewer than 6% of sovereign bonds are that long, according to Merrill Lynch, an investment bank.

Three things have spurred interest in longer-dated securities. People are living longer, for one. Pension savings are growing rapidly in markets (such as France) which once knew them not. And new rules (in the Netherlands, for example) are requiring pension funds to match their discounted assets and liabilities more exactly. Small wonder that the price of 30-year top-grade bonds has shot up. Since even young investors are desperate for yield these days, there just aren't enough long-dated securities to go round. The European Investment Bank issued a 50-year sterling bond in 2004, but at £200m ($359m) its impact can only have been small.

Not everyone is convinced that 50-year bonds are necessary. Some point out that 30-year bonds are not very different from 50-year ones where “duration” (sensitivity to interest-rate movements) is concerned. The match between assets and liabilities can usually be achieved by buying 30-year bonds and adding credit swaps, they suggest. New 50-year bonds may take liquidity out of the market for 30-year bonds, while themselves proving illiquid and hard to trade. But more people reckon there is enough demand for both.

If France does decide to launch a 50-year bond, it will make sure that the issue is liquid, says Benoit Coeuré, deputy general director of Agence France Trésor, the government's debt-management arm. He sees establishing an ultra-long benchmark interest rate as an important contribution to developing the euro-zone market.

Across the pond, Americans would do well to take note, points out David Goldman, head of debt research at Banc of America Securities. As politicians ponder how to reform the Social Security system by shifting more of the pension-savings burden to the private sector, the absence of anything approaching a new long-dated Treasury bond is striking. Adopting the 50-year Methuselah might be a bridge too far: three years ago, the Treasury abandoned new issues of even 30-year bonds. On this point, however, the Old World may well have something to teach the New.

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Executive Life

Heading for court

Feb 10th 2005
From The Economist print edition

Does the French government really want the embarrassment of a trial?

BRINKMANSHIP has played its part in the scandal over Executive Life, a bust Californian insurance company whose business and junk-bond portfolio were bought illegally in 1991 by Crédit Lyonnais, a bank then owned by the French state. Here we go again. Barring a last-minute settlement, the trial of a civil case brought by California's insurance commissioner, alleging fraud and seeking $3 billion on behalf of policyholders, will start on February 15th, six years after he filed the suit.

According to an American lawyer close to the case (there are dozens), neither Crédit Lyonnais, since privatised and taken over by Crédit Agricole, nor the Consortium de Réalisation (CDR), a state-owned body that has indemnified the bank against any losses arising from the case, has made an offer to settle out of court for more than the $350m that the CDR set aside for potential damages in this civil action as part of a settlement in 2003 of a parallel criminal case, brought by America's Department of Justice (DOJ). The commissioner is seeking at least $1 billion more.

A settlement might have been expected. In a hearing last November, Howard Matz, the judge handling the case, evidently not relishing a four-month jury trial, urged the French to settle. “I think the fraud can be proven...it isn't just going to be the plaintiffs win and here's the number. There are going to be all kinds of findings...if I were counsel to entities in France, I would want to make sure my clients understood,” the judge opined.

One defendant for whom a civil trial might be embarrassing is François Pinault, one of France's wealthiest businessmen and a close friend of Jacques Chirac, the country's president. Mr Pinault, who assisted the DOJ in compiling its criminal case against Crédit Lyonnais, testified to the grand jury empanelled to indict the bank. If his testimony were to be unsealed for use in the civil case, as lawyers have requested, the extent of his co-operation would become clear.

Judge Matz also had some strong words for the commissioner and his lawyers: they would “have to deal with utterly inconsistent testimony that will undermine their credibility”. He added: “Conjuring up some amount for damages...isn't going to be easy.” As Executive Life's business and junk-bond portfolio were sold to the highest bidder, the judge was sceptical that the commissioner would be able to prove that policyholders had suffered financially.

The commissioner may do better with his other claim. Arguing that those who commit fraud should not gain from it, he is after all the profit—around $2 billion before interest, he calculates—that Crédit Lyonnais and Artémis, one of Mr Pinault's holding companies, made from Executive Life. (In the 1990s, Artémis bought the insurance business and some of the junk bonds from Crédit Lyonnais.)

If he were to lose on this score, Mr Pinault would face a bill of up to $1 billion (before interest) as well as a finding that he had taken part in a huge fraud. That might test the validity of an

indemnity that Artémis has from the state-owned CDR—and, if the indemnity is valid, the patience of French taxpayers. Through Crédit Lyonnais, they in effect put up the money that allowed Mr Pinault to profit from Executive Life. They might balk at picking up the bill for his defeat in court as well.

So far Mr Pinault has apparently not offered a settlement of the civil action much beyond the $185m that Artémis paid to settle the criminal case. If he wants to count on his indemnity from the CDR, he cannot put more money on the table without the CDR's say-so.

The criminal case was settled at the last minute. Common sense suggests something similar ought to happen to the civil action too. Perhaps the CDR has not yet plucked up the courage to explain the predicament to its political masters.

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Riggs National and PNC

A deal of trouble

Feb 10th 2005 | NEW YORK
From The Economist print edition

The fall of an august institution

AFP

Looking less solid

FOR almost 170 years, Riggs National has been the bank of choice for the great and good of Washington, DC, and the world. The "bank of presidents" managed the accounts of 21 first families, including those of Abraham Lincoln and Dwight Eisenhower, financed the Mexican War and the purchase of Alaska, and handled most of the accounts of the diplomats that breezed through America's capital.

But along with the great and good Riggs also banked for the shady and sordid. In late January, the bank pleaded guilty to money-laundering offences concerning the accounts of various foreigners, including Augusto Pinochet, the former dictator of Chile. On February 7th, the proposed acquisition of Riggs by PNC Financial, a Pennsylvania bank that was to be Riggs's knight in shining armour, fell apart—only to be saved three days later.

Last July PNC agreed to pay $779m to buy Riggs as part of its strategy of expanding its bank network across the east coast. But fearful of Riggs's legal problems, PNC took precautions. It negotiated the right to walk away from the transaction should Riggs suffer a "material regulatory impairment" before the deal's close. After Riggs's guilty plea last month, PNC began sidling away. It slashed its original offer by 20% and demanded that Riggs settle or put aside reserves for private lawsuits outstanding against it, including one on behalf of the victims of the terrorist attacks of September 11th 2001.

Riggs's board of directors unanimously rejected the offer—and sued, to force PNC to honour the original deal or, failing this, to pay Riggs for the "resulting damage" caused by the failure of the acquisition. But on February 10th Riggs suddenly agreed to be bought by PNC for $654m.

Recent events have scarcely made Riggs a more attractive target. Other potential buyers would have been likely to think twice before acquiring a bank faced with mounting legal fees and continuing investigations. Riggs is still working with regulators to revamp its money-laundering controls. In its latest financial report, Riggs estimated that it spent $20m in the fourth quarter of last year dealing with investigations and lawsuits and strengthening its internal systems. Then there are fines. Riggs suffered a $25m civil penalty from the Treasury Department last May. The price of last month's admission of guilt was a $16m fine, which may be increased.

Beyond this is the worry that Riggs's sullied reputation could affect its core operations. The bank's main attraction is its branches: 51 of them in and around Washington, one of the wealthiest areas in America. But most of its branches are in urban areas, not the faster-growing suburbs.

Riggs's books look poor, too. It lost $100m in 2004, $60m of it in the fourth quarter. Its deposits slid from $4.3 billion at the end of 2003 to $3.0 billion in December last year. Much of this reduction is likely to have been the result of the shedding of its embassy businesses, but some of it might have been the consequence of customers switching to banks with cleaner reputations. Worse, on February 8th Moody's, a credit-rating agency, downgraded Riggs's debt, which could lead to a higher cost of borrowing. It has been a long fall for the bank of presidents.

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Economics focus

Sheltered market

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Restrictions on building can help explain why house prices are so dear

AS HOUSE prices have soared in many rich countries in recent years, most observers of the property market have pointed to rising demand as the source of the boom. However, cheap money and rising incomes are not the whole story. Government limits on the supply of new homes have often been overlooked. But they have also helped push up house prices—especially when inflation over a long period is considered.

In markets for, say, carrots or cars, rising demand raises prices in the short run. That encourages producers to make more, which brings prices back down eventually. But houses are no ordinary good: when demand for them rises, increasing the supply can be difficult. Not only do they take time to build: building them at all can be hard, owing to planning laws (known as "zoning" laws in America) governing the use of land, the density of housing and the heights of buildings. In Europe, such restrictions have long been accepted. In America, thanks perhaps to a lower population density and greater popular support for home ownership, the right to build has historically been much less fettered.

But that has changed drastically in recent decades in the most populated parts of the country, such as the north-east coast and California, according to a new paper* by Edward Glaeser and Raven Saks, of Harvard University, and Joseph Gyourko, of the University of Pennsylvania. They studied the housing markets of more than 300 American cities since 1950 and have pieced together evidence of regulation-induced inflation in many places. Having measured this burden, they attempt to explain its origin.

The authors report that in the two decades after 1950, American house-price rises were almost entirely caused by increases in construction costs. Between 1970 and 2000, however, building costs were virtually stagnant in real terms, thanks to greater efficiencies. Yet real house prices kept on rising. Moreover, the variance in prices widened. In 1960, properties in the highest-priced decile were 50% more expensive than those in the lowest-priced decile; by 1990, the margin was 200%.

Reasoning that the price of a house reflects not just the costs of construction and land, but also the value of permission to build, the authors set out to estimate this value. By 1980, only a few cities, such as Los Angeles and San Francisco, saw house prices rise faster than physical building costs. By 2000, the value of permission to build was more than 40% of the price of property in 27 cities. In Los Angeles, the housing stock grew by less than 10% during the 1990s, down from 60% in the 1950s. In many cities, prices rose while supply growth slowed sharply.

Perhaps as cities grew the amount of available, suitable land dwindled? The authors say this explains only a little of the slowdown in supply. Housing growth abated in many places where

existing dwellings were sparse, especially in California. In a related paper†, the authors look at Manhattan, where free land is so scarce that the cost of a new unit of housing is simply that of adding an extra floor to a building. Comparing this cost with the market price of housing, the authors estimate that the regulatory “tax” of Manhattan's planning laws has risen to more than 50% of the average price of an apartment.

Still, New York's zoning rules might be economically justified if they reflect the costs imposed by additional residents on those already living in Manhattan. The authors first estimated the value of views and sunlight lost when new flats are built. Then they examined the costs of extra congestion and of new public services, such as schools, sewers and so forth. By their calculation, all these costs taken together could not come close to explaining such a high regulatory burden. In other words, the zoning “tax” was much higher than the cost to existing residents of having new people in the neighbourhood.

To try and explain the constraints on supply, the authors delve into political economy. Perhaps, they wonder, judges and regulators have become more protective of the environment. However, direct evidence for that is lacking. Or maybe property developers have become less adept at making political contributions, or paying straight bribes, to the right politicians. Then again, American politics scarcely seems short of money. Nevertheless, the authors' favourite theory is that existing home-owners have become better at organising themselves politically to thwart new building.

Not in my backyard, or anywhere near

Since housing is by far the biggest expense for most people, any source of house-price inflation matters. Although zoning restrictions are often welcomed on the grounds of preserving the benefits of rural charm or urban character, their cost tends to fall disproportionately on poorer people, says Mr Glaeser. By raising property values, planning laws act as a windfall for existing owners and a burden on those who rent or seek to buy. Since renters typically have lower incomes and wealth, zoning is often a highly regressive form of taxation, he says.

One lesson for rich-country governments, says Mr Glaeser, lies in the way that they help people who cannot afford adequate shelter. Billions are spent every year on “affordable housing” schemes, either through grants or by requiring a certain portion of newly built units to be sold or rented at below-market prices. This latter requirement is, in effect, yet another a tax on new building. A more effective and cheaper way to make housing more affordable, he reckons, is to loosen restrictions on new construction. It is inconsistent, surely, for a government to offer help with one hand, while holding back the supply of housing with the other.

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* “Why Have Housing Prices Gone Up?” Forthcoming in the *American Economic Review*

† “Why is Manhattan So Expensive? Regulation and the Rise in House Prices”. Forthcoming in the *Journal of Law and Economics*

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Computing

The cell of a new machine

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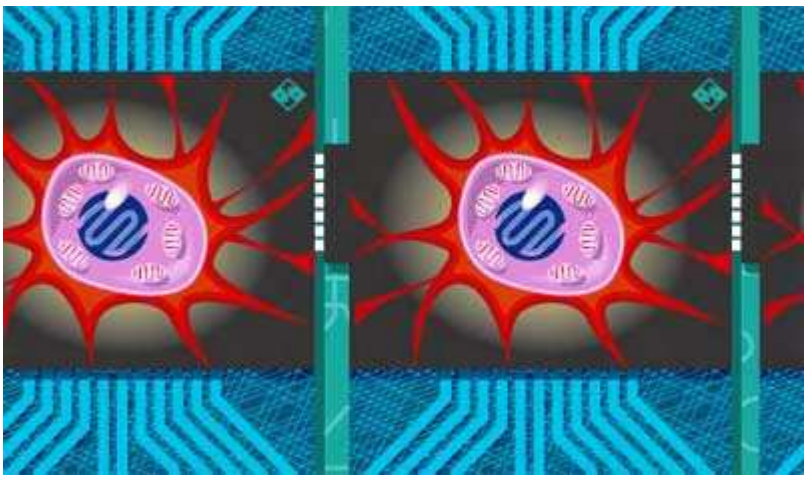

Is the new Cell chip really as revolutionary as its proponents claim?

ANALOGIES are often drawn between the fields of computer science and biology. The information-processing abilities of DNA are a form of natural molecular computing, and computer viruses leap from machine to machine in ways reminiscent of their disease-causing namesakes. At the International Solid-State Circuits Conference in San Francisco this week, a trio of mighty information-technology firms—Sony, Toshiba and IBM—pushed the analogy a little further. They unveiled a much anticipated new computer chip, four years in the making, the very name of which is a biological metaphor: the Cell.

As its name suggests, the Cell chip is designed to be used in large numbers to do things that today's computers, most of which are primitive machines akin to unicellular life-forms, cannot. Each Cell has as its “nucleus” a microprocessor based on IBM's POWER architecture. This is the family of chips found inside Apple's Power Mac G5 computers and IBM's powerful business machines. The Cell's “cytoplasm” consists of eight “synergistic processing elements”. These are independent processors that have a deliberately minimalist design in order, paradoxically, to maximise their performance.

A program running on a Cell consists of small chunks, each of which contains both programming instructions and associated data. These chunks can be assigned by the nucleus to particular synergistic processors inside its own Cell or, if it is deemed faster to do so, sent to another Cell instead. Software chunks running on one Cell can talk to chunks running on other Cells, and all have access to a shared main memory. Since chunks of software are able to roam around looking for the best place to be processed, the performance of a Cell-based machine can be increased by adding more Cells, or by connecting several Cell-based machines together.

All of this means that programs designed to run on Cell-based architecture should be able to fly along at blistering speeds—and will run ever faster as more Cells are made available. The prototype Cell being discussed this week runs at 256 gigaflops (a flop—one “floating-point” operation per second—is a measure of how fast a processor can perform the individual operations of digital arithmetic that all computing ultimately boils down to). A speed of 256 gigaflops is around ten times the performance of the chips found in the fastest desktop PCs today; the Cell is thus widely referred to as a “supercomputer on a chip”, which is an exaggeration, but not much of one. On the top500.org list of the world's fastest computers, the bottom-ranked machine has a performance of 851 gigaflops. A machine based on only four Cell chips would easily outrank this.

Hard cell

If you believe the hype, all this has other chipmakers—notably Intel, whose Pentium series is the market leader—quaking in their boots. No doubt they are nervous. After all Andy Grove, one of Intel's founders, called his most famous book “Only the Paranoid Survive”. But it is not yet clear that Cell will sweep all before it. The reason is that existing programs have not been designed in the chunky way required if they are to run on Cell-based machines—and rewriting them would be a monumental task.

For the moment, that will not worry Cell's designers because the kinds of things Cell chips are intended to be used for require specially designed software anyway. Cell chips are well suited to processing streams of video and sound, and for modelling the complex three-dimensional worlds of video games, so Cell's debut will be in Sony's next-generation games console, the PlayStation 3, which is expected to contain four of the beasts. Cell chips will also be ideal for use inside consumer-electronics devices such as digital video-recorders and high-definition televisions. Both Sony and Toshiba plan to use Cell chips in such products. For its part, IBM is talking up the Cell's potential to power supercomputers, the fastest of which, IBM's Blue Gene/L, consists of thousands of special chips that are, in many ways, more primitive versions of Cell. Using Cell chips instead would not, therefore, be a big stretch. And supercomputer programmers, like video-game designers, do not mind learning to program an entirely new machine provided it delivers the performance they are seeking.

If Cell did eventually break out of these specialist applications and into general-purpose computers, Intel would have every right to be paranoid. But Kevin Krewell, the editor of *Microprocessor Report*, an industry journal, sounds a note of caution. The Cell is too power-hungry for handheld devices, and it would need to have its mathematical functions tweaked to be really suitable for use in supercomputers. The Cell is impressive, but, in Mr Krewell's view, “it is no panacea for all those market segments”. Similar claims to those now being made for Cell were made in the past about the Sony/Toshiba chip called the Emotion Engine, which lies at the heart of the PlayStation 2. This was also supposed to be suitable for non-gaming uses. Yet the idea went nowhere, and the company set up by Toshiba to promote other uses of the Emotion Engine was closed down.

Extravagant claims were also made about the RISC, POWER and Transmeta architectures, notes Dean McCarron, a chip analyst at Mercury Research in Scottsdale, Arizona. These once-novel methods of chip design have done respectably in specialist applications, but have not dethroned Intel as it was suggested they might when they were launched. Yet both Mr McCarron and Mr Krewell acknowledge that things could be different this time. As Mr McCarron puts it, there are “more ingredients for success present than on previous attempts”. Intel was able to see off earlier pretenders to its throne by increasing the performance of its Pentium chips, and by exploiting its economies of scale as market leader. But in this case, the performance gap looks insuperable, and Sony, Toshiba and IBM plan to exploit economies of scale of their own.

Quite how revolutionary the Cell chip will turn out to be, then, remains to be seen. And though it may not be an Intel killer, it could prevent that firm from extending its dominance of the desktop into the living room. Consumer-electronics devices, unlike desktop PCs, do not have to be compatible with existing software. In that sense, the Cell does pose a threat to Intel, which regards the “digital home” as a promising area for future growth. Stand by, therefore, for another round of creative destruction in the field of information technology. And no matter what the Cell does to the broader computer-industry landscape, the virtual game-vistas it will conjure up are certain to look fantastic.

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Data storage

Shaken, not stirred

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The answer to slow data retrieval may be to shake the system up

COMPUTER processors may be getting faster and faster (see article) but the time it takes to retrieve data from a computer's hard disk is still a bottleneck. That rate depends on the speed at which the disk is spinning, which in turn determines how quickly a given bit of data arrives under the reading head that is responsible for detecting it and transmitting it to the rest of the machine.

Modern hard disks spin at between 5,400 and 15,000 revolutions per minute (rpm). If they went much faster than that, the forces generated would cause them to shatter. For years, this has seemed an insuperable problem, and the industry has been waiting for solid-state memory, which has no moving parts, to become cheap enough to do the job instead. But Dataslide, a firm based in Sussex, Britain, believes it has a revolutionary solution to the retrieval problem that does not require waiting for solid-state mass memory—or, rather, it has a non-revolutionary one.

Dataslide proposes to abandon rotation in favour of vibration. Charles Barnes, the head of Dataslide and inventor of the vibrating drive, has produced a prototype drive containing a rectangular plate coated with magnetic-storage material similar to that used in disk drives. A second plate above it carries an array of heads that have been lithographed on to its surface using the technique employed to make the pixels of liquid-crystal display screens. The plates themselves are made of titanium silicate glass, an extremely strong material, and covered with low-friction diamond coatings which act as a lubricant. That is because, instead of spinning under the heads, the lower plate vibrates from side to side under them 600 times a second.

The upshot is that every spot on the lower plate passes under a reading head every 833 nanoseconds (a nanosecond is a billionth of a second). The average time required to read a given bit of data is therefore 417 nanoseconds—or about ten times faster than a disk spinning at 15,000rpm. And that, Mr Barnes hopes, is only the start. He believes that with currently available materials and technology it should be possible to increase the frequency of vibration to 100,000 times a second, equivalent to a disk rotating at 12m rpm.

For the moment, the company's goals are more modest—within 18 months it hopes to build a drive with 64 heads storing up to 72 gigabytes. Mr Barnes believes it will eventually be possible to make drives with over 1m heads. These would be capable of storing vast amounts of data and handling them at rates of up to 300 gigabytes a second—hundreds of times faster than the rates that are currently attainable.

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Scientific publishing

Who pays the piper...

Feb 10th 2005
From The Economist print edition

The advance of open-access publishing

FOR around a decade, a group of campaigners has been arguing that the public should not have to pay to read the results of the scientific research which it has, through its taxes, financed. Feelings about the issue are particularly high when it comes to government-funded medical research. Patients' rights groups argue vociferously that it is ethically wrong to charge for access to the latest medical discoveries.

Needless to say, most existing publishers of such information, who make a good business out of selling it to what is more or less a captive academic audience, are not too keen on the idea of "open access"—ie, publication free to anyone. But open access seems to be on its way. On February 3rd America's National Institutes of Health (NIH), the world's biggest sponsor of medical research, announced that from May it will expect the research work which it has helped to finance to be made available online, to all comers, and free, within a year of that research having been published in a journal. The NIH also plans to make it easy for researchers to do its bidding by spending $2m-4m a year supporting an electronic archive into which these papers can be deposited. This will be managed by America's National Library of Medicine.

The NIH's decision represents a big change. The $30 billion that it spends on research each year leads to the publication of around 60,000 papers annually—some 11% of the total published in the medical field. Indeed, the organisation says that its actual impact is much higher, with 30-50% of the most important papers (the ones that get cited extensively by other researchers) having had NIH sponsorship. And although its new policy does not actually oblige its scientific dependants to make their work available this way, when a big paymaster asks its researchers to jump, in most cases the response is going to be "how high?"

A victory, then, for the open-access campaigners. But only a partial one. The NIH's announcement is actually a retreat from the proposal originally circulated last year, which was for open access within six months of first publication. The NIH appears to have backed down under pressure from commercial publishers, as well as from professional societies that fund their activities by publishing journals. Elias Zerhouni, the NIH's director, acknowledged that the step back was an attempt to "preserve the role" of these groups.

Nevertheless, in the publishing arena the NIH is something of a bull in a china shop. Even if it tries to tiptoe around, it is hard to see how there will not be some breakage. Dr Zerhouni himself touted the new policy as one that would "transform" and "change the landscape" of biomedical publishing. Publishers are going to have to find a way of adapting to those changes. The NIH is saying, in effect, that they could have as much as 12 months to make a profit. And while this may not please them, if any of the medical journals were to decide not to accept the new terms under which NIH researchers must publish they would have to be prepared to lose a large proportion of their best research papers.

Another reason the NIH decision is important is that it could establish a standard for other organisations that fund research. The Wellcome Trust, a large charitable research foundation based in Britain, is also a strong supporter of open access. It is currently discussing with the National Library of Medicine the possibility of a joint, global archive of papers. Though by no means as powerful as the NIH, the Wellcome Trust helps to finance research that leads to the publication of around 3,600 papers a year. Ultimately the trust wants that research available free within six months of publication in a journal. For commercial scientific publishers the days of wine and roses may be numbered.

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Animal behaviour

Love me, love my dog

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Dogs and their owners really do resemble one another

A FEW years ago, some researchers studying human mating patterns tried the following experiment. They took photographs of individuals in established relationships, mixed them together, and asked their experimental subjects to pair up likely looking couples from the pictures. More often than chance, the photo-couples thus created were also real couples.

This is an example of what biologists call assortative mating—that who chooses whom (and also who is willing to be thus chosen)—is to some extent predictable. But despite the corny observation that owners grow to look like their dogs and *vice versa*, no one really expected the same rules to apply to people and their pets.

But it seems they do. A paper published in the *Journal of Ethology* by Christina Payne and Klaus Jaffe, of Simón Bolívar University in Venezuela, describes a visit they made to the National Canine Exposition in Caracas. There, they photographed 36 purebred dogs and their 36 owners. The pictures were manipulated to remove the background and the owners' clothing (fear not—the clothes were just blanked out to create a shot of the head). The prints were then split into six groups of pairs, and each group was shuffled.

Dr Payne and Dr Jaffe asked their volunteers to try to guess which dogs within a group belonged to which human. As in the case of human couples, correct guesses were made significantly more often than chance. It seems, therefore, that owners really do resemble their dogs.

That is not, however, because dog and owner have grown alike over the years. Dr Payne and Dr Jaffe checked this by looking at the correlation between the likelihood of a volunteer making a correct pairing and the amount of time dog and human had cohabited. There was none.

More intriguingly, the volunteers were unable to make reliable pairs in a follow-up study in which the dogs involved were mongrels rather than pedigree. That, the two researchers reckon, may be the key to the mystery. When you buy a pedigree puppy you have a good idea what the adult will look like. Not so with a mongrel.

Although they have yet to prove it, the hypothesis that Dr Payne and Dr Jaffe are considering is that people's preferences for dogs that resemble themselves is an accidental manifestation of another phenomenon. This is the well-established observation that people are more trusting of those who look somewhat like them, presumably because resemblance suggests genetic relatedness. In experiments where contestants have to bargain for money, for example, a potential “business” partner elicits more trust if he or she has a face similar to the bargainer. And if dogs are truly man's best friend, then trust is surely an important part of the friendship.

The Richard Casement internship

Feb 10th 2005
From The Economist print edition

We invite applications for the 2005 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 21st. They should be sent by e-mail to casement@economist.com

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The battle of Waterloo

Beating Boney

Feb 10th 2005
From The Economist print edition

Corbis

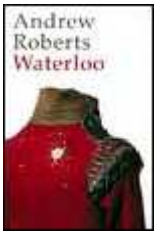
Waterloo, to many, still represents England's finest fighting moment. Andrew Roberts's new book cannot resist rubbing French noses in it

WALK into any major European art gallery and you are likely to see soldiers, cavalry and cannon spread across huge canvases. In some, the troops line out across the plain under the watchful gaze of a general. Others show the battle up close, often in a moment of conspicuous heroism—the capturing of a standard, say, or a cavalry charge.

This genre dates from the period between the French revolution and the end of the Victorian era, but after that time it suddenly disappears, killed off by new, more scientific ways of writing history and by fundamental changes in how warfare was imagined. The battles that Tolstoy describes in “War and Peace”, which was published in the late 1860s, were neither tidy nor heroic. Even less so were the muddied struggles of the first world war. Treating them as if they were suddenly seemed naive.

Andrew Roberts's new book, “Waterloo: Napoleon's Last Gamble”, takes the reader back to a war zone that resembles the big paintings. Although Mr Roberts does write about the difficulties of battlefield communications (the Duke of Wellington kept losing the *aides de camp* whose job it was to convey his orders and ended up relying on passers-by), Napoleon and Wellington are definitely directing the picture, rather than sitting in the back row munching popcorn. It is also unashamedly grand. So much so that the soldiers sometimes seem to have been displaced from a 1950s

Waterloo: Napoleon's Last Gamble
By Andrew Roberts



To be published in America next month as "Waterloo, June 18, 1815: The Battle for Modern Europe"; 144 pages; $21.95
HarperCollins; 143 pages; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Hollywood epic. Mr Roberts has one British general “shot through the right temple with the words ‘Charge! Charge! Hurrah’ upon his lips.”

In some ways this is appropriate. When Napoleon faced Wellington on June 18th 1815, it certainly was a grand affair. Wellington was at a ball when the news came that Napoleon's troops were moving, so several officers fought in evening dress. The armies were vast. There were around 218,000 men in the field that day, more than twice the number at Blenheim a century earlier. More than 70,000 died or were wounded.

The sense of occasion did not come from the fact that the battle was “a marker, a turning point, an epoch-making incident, a directional laser-beam of light from the past to the future,” as Amanda Foreman and Lisa Jardine write in their somewhat over-wrought introduction. Waterloo was rather a chance for the “disturber of world repose”, as the congress of Vienna had branded Napoleon, to put off his reckoning with France—which was tired of its revolution and craved quiet—and with the rest of Europe; and also to burnish his immortality before returning to jail.

The battle of Waterloo unfolded in five phases, which Mr Roberts lays out quite clearly. The early part of the day was taken up with a French advance on buildings held by English troops and their allies, which had to be taken before any attack on Wellington's main defences could begin. Then Napoleon launched his infantry on the centre-left of Wellington's line, followed by a cavalry charge on the allied infantry, which had formed into strong but brittle squares. The defence was made impassable at the end of the day when Prussian troops arrived in large numbers. Then the allied advance began, and it continued until nightfall, with Prussian cavalrymen lancing French soldiers in the back as they retreated.

Did Wellington outwit Napoleon,as well as winning the battle? Some 19th-century French historians thought not, blaming the ex-emperor's defeat on fatigue, or on a mysterious ditch that is supposed to have swallowed up his cavalry. Mr Roberts has not time for any of this. He points out that Wellington chose his ground well. Waterloo was narrower than most Napoleonic battlefields, which ruled out the kind of wide flanking manoeuvre that had brought Napoleon success before. A second decisive factor was Napoleon's reluctance to deploy his Imperial Guard at a moment when they might have turned the battle, preferring to preserve them until the fighting was almost over.

Mr Roberts is very adept at entertainment, and has made a good career as an after-dinner speaker. That may be one reason why his book sounds so wildly partisan. At the end of the battle, when Napoleon's last troops are being mangled by artillery, Mr Roberts writes that “the carnage was terrific”.

Add attitude to a grandiloquent style—“Shakespeare would easily have recognised the role that hubris and arrogance played in Napoleon's downfall,” Mr Roberts announces early on—and you begin to have the tiresome impression that the target reader is a retired brigadier in the English shires who delights in using the pepper grinder and a few spoons to play out the moment when Anglo-allied forces routed Boney. Our brigadier may place the silverware just so, but the other guests at the table are more likely to remember him as rather boorish and overbearing.

By Andrew Roberts.
HarperCollins; 144 pages; $21.95
HarperCollins; 143 pages; £12.99

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The Erie canal

Waters of wealth

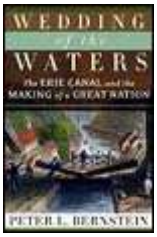
Feb 10th 2005
From The Economist print edition

AMERICA'S girth may seem inevitable today, at least to many Americans. But it was not always thus. The early nation consisted of only 13 states along the Atlantic, separated by the Appalachian mountains from a vast hinterland. Britain, France and Spain looked enviously at this virgin timber, rich soil and endless supply of fur. As more Americans ventured west, to the area that today plays host to many “red” states, the country's founders saw that this land might easily drift out of their control if it lacked intercourse with the coast. The idea of a canal was born.

But building a waterway to link the Atlantic and the Great Lakes (“our Mediterranean”) was easier said than done, as Peter Bernstein recounts in his lively and engaging new book. George Washington had failed in a bid to use the Potomac river to create a viable waterway over the mountains. Later, private companies tried to improve New York state's rivers, but they were stymied by debt, difficult terrain and inadequate engineering.

Yet at least one early American, Elkanah Watson, had studied the great canals of Europe, such as France's Canal du Midi. It was reckoned that an artificial waterway would reduce the cost of moving cargo from the inland lakes to New York City by 90%. Yet even Watson knew that his vision would be likened to building “a canal to the moon”.

Wedding of the Waters: The Erie Canal and the Making of a Great Nation
By Peter L. Bernstein



Norton; 352 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

Mr Bernstein is at his best in showing how a colourful group of American politicians turned this dream into reality. From wealthy patriarchs of Dutch and English families, to the Tammany Hall crowd, who showed their disdain for all things European by adopting Native American names, the book provides a splendid window into early American life, which was as raucously divided then as it is now by class and taste.

The project, which took eight years and was finished in 1825, was always bogged down by politics. Some upstate New Yorkers feared that the canal would bring in a flood of cheaper goods from the new lands. Thomas Jefferson issued an early warning about the waste that is inevitable with government sponsorship. Others feared that the new world of high finance, with its bonds and foreign—meaning British—investors, might tip the balance of power towards Alexander Hamilton's world of banks and business, and away from the Jeffersonian yeoman farmer.

Mr Bernstein tells how the canal's fortunes were buoyed by America's first home-grown financial crisis, which encouraged banks to become over-easy lenders. It was also the moment when the young country realised for the first time that private enterprise may not always be sufficient to ensure a project's success.

In the end, though, was the Erie canal quite so indispensable in forging the new nation? Perhaps not, for the railways would have reached the interior eventually. But in Mr Bernstein's telling, it did as much to give Americans a vision of themselves as a great trading nation as in moving goods to market. That is quite a lot to expect from a ditch only four feet deep and 40 feet wide.

Wedding of the Waters: The Erie Canal and the Making of a Great Nation.
By Peter L. Bernstein.
Norton; 352 pages; $24.95

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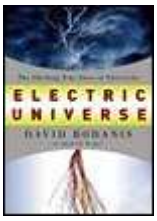
Popular science

Power to the people

Feb 10th 2005
From The Economist print edition

IT WOULD be difficult to imagine a world without electricity—not least because electrical forces hold atoms together and make our brains work, as David Bodanis observes in his entertaining new survey of electricity and how it has transformed the world.

Electric Universe: The Shocking True Story of Electricity
By David Bodanis



Crown; 320 pages; $24.
Little, Brown; £14.99

Buy it at
Amazon.com
Amazon.co.uk

Mixing readable explanations with quirky biographical details, he relates the stories of the telegraph, the telephone, electrification, radio, radar and computers, and of the people behind them. His breezy, often poetic prose makes even the most complex subjects seem accessible to non-specialist readers, as in his previous book, "$E=mc^2$", a biography of Einstein's famous equation. Alexander Graham Bell's development of the telephone, inspired by his love for a deaf woman, reads like a romance; the tale of the daring wartime raid in which British troops stole a German radar station reads like a thriller. It is all great fun.

But Mr Bodanis's style is not for everyone, and one man's poetry is another man's inaccuracy. Readers with a modicum of technical knowledge may find themselves tripping over some of his turns of phrase. Does Prozac, when swallowed, "actually turn into liquid electricity?" Is metal opaque because it is a conductor of electricity, while glass is transparent because it is an insulator? Do electrons fall out of the ends of wires or not? The notes section shows that Mr Bodanis understands what he is talking about in far more detail than you might conclude from the main text. Evidently he is trying to strike a balance between readability and strict accuracy, and seems to favour the former over the latter.

Does this matter? After all, Mr Bodanis is not writing for the specialist, but for the general reader looking for an accessible introduction to a particular field. Non-specialist readers whose interest has been well sparked may be tempted to move on to meatier works, but they may also end up thinking that they understand the subject better than they really do.

It is possible to simplify the science in a way that does not offend readers with deeper knowledge of the subject, and many of the passages in Mr Bodanis's book do, in fact, pull this off. Yet given his undoubted skill at sugarcoating otherwise unpalatable scientific explanations with jolly personal tales, he should not be afraid to inject a little more rigour and detail into his pop-science confections.

Electric Universe: The Shocking True Story of Electricity.
By David Bodanis.
Crown; 320 pages; $24.
Little, Brown; £14.99

New fiction: Dean Bakopoulos

Our fathers

Feb 10th 2005
From The Economist print edition

IT IS the early 1990s, and a great many of the men in Maple Rock—Dean Bakopoulos's fictional working-class, Ukrainian-Polish-Greek bit of Detroit—are still out of work and deeply depressed. They start to drift away, though not in any recognised manner. They simply disappear, abandoning their families without a word, though one of them does leave a note announcing that: “I'm going to the moon.” Their deserted children half-believe this is the truth.

Please Don't Come Back From the Moon
By Dean Bakopoulos

Harcourt; 273 pages; $23

Buy it at
Amazon.com
Amazon.co.uk

Mr Bakopoulos's well-told debut novel is the first-person story of the coming-of-age of one of the sons, Michael Smolij (16 when his father vanished) and his friends. The boys' mothers, strong women, mostly pull themselves together, find new men, and move on. Michael's own mother eventually sets up with a Ukrainian soon-to-be-ex priest, taking his younger brother with her.

But the teenage sons linger on in their dire neighbourhood, drinking beer, skipping school, lusting after local girls. When a shopping mall opens, most of them fall gratefully into dead-end jobs, serving smoothies and sandwiches. Michael sells books at a place called Book Nook. So does his girlfriend, Ella, who lives with her little boy in the Pink Flamingo trailer park and earns the extra cash she needs by competing in the weekly Hump Day Honey Bikini Contest, held at the Happy Wednesday bar.

Michael's cousin, Nick, a stronger but sadder character, momentarily breaks through the general lethargy by organising a sit-down strike at the mall for the Friday after Thanksgiving, America's biggest shopping day. He is inspired by the brave strikes of 1937, but this is now. Without a union, even a feeble one, the mall workers don't stand a chance. Sheepishly they go back to work, quoting new imperatives as husbands and fathers.

Michael takes classes and gets himself a better job at the local radio station. But Nick, the instinctive leader of the group, seems also to be leading them back, to follow their fathers by embarking on that barren journey, to the moon or wherever. Mr Bakopoulos's fantasies may not be to everybody's taste, but his picture of confused, aimless young men in a forgotten corner of prosperous America is haunting. “Perhaps we had dreams. To be honest, we couldn't remember them,” they lament. One yearns for these youngsters to look to themselves, and their much nicer young women, and to forget their sad fathers.

Please Don't Come Back From the Moon.
By Dean Bakopoulos.
Harcourt; 273 pages; $23

New fiction: John Updike

Too tired to

Feb 10th 2005
From The Economist print edition

HAVING created salacious fiction for decades, John Updike, with 20 novels under his belt, seems suddenly at the age of 72 to have tired of sex itself—or perhaps he has tired of writing about it. Although it contains many distinguished passages, his latest novel, which comes out in Britain this month, is conceptually generic. And it is hard to say whether the world of letters has been changed in the slightest by its publication.

Villages
By John Updike

Knopf; 321 pages; $25.
Hamish Hamilton; £17.99

Buy it at
Amazon.com
Amazon.co.uk

Set in a series of insular small Connecticut towns, “Villages” chronicles the two marriages and accelerating infidelities of Owen Mackenzie. An electrical engineer, Owen designs software, starting in the heady, creative days of the earliest computers. Mr Updike's technical digressions as computers progress from clunky contraptions to slender laptops are more fascinating than Owen's peccadilloes—though one senses that his research of both has been thorough. Even so, a good book on the history of the computer should provide amply more information on the topic than “Villages”, and the interesting non-fictional titbits slipped into the text cannot justify all the dreary nooky in between.

The plot is easy. Owen marries, philanders and marries again. Thus the main events comprise conquering women and abandoning them. Indeed, the novel seems to round on the notion that sex redeems existence—or at least the existence of women: “Two kinds of women existed in the world, Owen perceived: those with whom you have slept and those, a cruelly disproportionate but reducible number, with whom you haven't.” Despite his hero's appetite, Mr Updike's words can seem misogynistic. When he writes, “How lovely she is, naked in the dark! How little men deserve the beauty and mercy of women!” condescension screams from the page.

It is hard to understand how an author who once wrote so well about sex can drift into writing about it so badly. Perhaps a phrase such as “her convex thighs curved steeply inward where they met and transformed, without violating her fundamental homeomorphism, into a concavity delimiting another sort of space” could only have been written by an author who has described a few too many thighs.

To be fair, most of “Villages” is a cut above this. But for much of the novel, Mr Updike seems to be sleep-walking, mechanically referencing Haight-Ashbury or “Shampoo” to thumbnail an era. Ultimately, his point, too, is reductive. “Owen's past is like a sheet of inky blue tissue paper held up to the light, so the holes pricked in it shine: these stars are the women who let him fuck them.” The pinholes seem dismally insufficient.

Villages.
By John Updike.

Knopf; 321 pages; $25.
Hamish Hamilton; £17.99

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The Caucasus

Unreal city

Feb 10th 2005
From The Economist print edition

LIKE no other place on earth, the Azerbaijani capital of Baku encapsulates everything about the Orient which westerners find enticing, deceptive and spine-chilling. On a moonlit night, its walled Persian quarter has a fairy-tale charm—but to anyone with a vivid imagination, it often seems that a *jinn* or fallen angel lurks in the shadows.

If Baku's atmosphere seems charged, that is mainly because of the liquid that oozes from the earth and lends its odour to the blustery wind. Caspian oil has drawn in many faiths and cultures: Muslims, Christians and Jews as well as Turks, Persians and Slavs. There have been times of benign co-existence; times of wild decadence; and times of violence between suitors for Baku's wealth and beauty.

This is the environment which produced Lev Nussimbaum, a mysterious literary figure whose best-known book is “Ali and Nino”, a love story between a Muslim Azeri and a Georgian Christian. Writing as Essad Bey and Kurban Said, he achieved literary success in fascist Europe—first Germany and later Italy—by concealing his Jewish origins and re-inventing himself as a Muslim prince.

The Orientalist: Solving the Mystery of a Strange and Dangerous Life
By Tom Reiss

Random House; 464 pages; $25.95.

Buy it at
Amazon.com
Amazon.co.uk

Tom Reiss spent six years piecing together the story of a man who was born in Baku in 1905 into a petro-elite whose world was wrecked by revolutionary violence. Thanks to Mr Reiss's detective work, it becomes clear why Nussimbaum turned fantasy—about himself, and those around him—into an art and a tool for survival.

The hero's boyhood included both luxury and trauma. His father was a well-connected tycoon, his mother a revolutionary who took her own life when he was about seven, leaving him in the care of a German nanny. The Muslim east was on his doorstep, but as violence raged in the streets, the family cowered in the cellar of its mansion. Fleeing in a camel caravan with his father across Central Asia, the young Lev was exposed to an even more exotic world. This offered new material for his fantasies and fresh evidence of the prudence of hiding one's identity. To a lady's man, literary lion and staunch anti-communist in Hitler's Germany (prepared in some contexts to defend Nazism), the need for a thick smokescreen was more obvious still. In the end, the disguise did not quite work; his origins were denounced by his embittered wife Erika Loewendahl, an heiress who regretted her initial faith in his claims to be of a “princely Arab lineage”.

Mr Reiss takes the reader through his own search for the truth; through the twists of 20th-century history in Russia and Germany, and hence though the life-story itself. This would be hard work if the inter-weaving of biography, investigation and geopolitics were not so elegant.

Many a reader will wonder about the future of Baku, a century after Lev's birth. What new tales of clashing civilisations, and ambivalent identities, will unfold there? The city is again experiencing an oil boom, and again in the eye of a strategic storm. In the capital of a fragile post-Soviet state, a noisy lobby wants war to settle scores with the Armenians. Only if Baku's latest suitors work hard to preserve peace can the risk of fresh bloodshed in these haunted streets be kept at bay.

The Orientalist: Solving the Mystery of a Strange and Dangerous Life.
By Tom Reiss.
Random House; 464 pages; $25.95.
To be published in Britain by Chatto & Windus in July

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Installation art

Gold sheer

Feb 10th 2005 | CENTRAL PARK, NEW YORK
From The Economist print edition

Christo finally wraps up the city

WHEN the Bulgarian-American wrap artist, Christo and his wife Jeanne-Claude, first proposed strewing candy-coloured sheeting through Central Park in 1980, the authorities' resounding no the following year came in a letter that ran to 107 pages. As the New York City parks commissioner Gordon Davis summed it up later, the proposal was for the “wrong place, wrong time, wrong scale.”

AP

Hair harmony

By 1991, the rejection had slimmed down to 26 pages. Things were looking up. There followed further talks, negotiations and compromises—even a new mayor—before no turned to yes. Approval notwithstanding, there has been plenty to be getting on with: over 60 miles of vinyl tubing to produce and some 1m square feet of special rip-stop nylon fabric from 116,389 miles of thread. On February 12th the Christos will finally be ready (weather permitting) to begin unfurling panel after panel of the saffron fabric from the 7,500 tall vinyl tube gates that have been planted along 23 miles of footpaths in the park.

“The Gates, Central Park, New York, 1979-2005”, as the installation is formally called, has been going up all week. At the finale, each curtain will drop to a height of about seven feet (just over two metres) above the ground, offering the city's dogs and dandies a flash of colour through which to view the bare winter trees.

The project's entire cost (including insurance) will be financed by the artists, who are selling studies, preparatory drawings, collages and scale models of the project. The Christos are also donating $3m to New York City's parks programmes as part of the deal. In addition to these

financial details, the artists are particularly keen for people to know that they are intent on creating a democratic installation. No one can own the work, they say, and no one must pay to see it. By contrast, everyone who visits “The Gates” will own the experience, and after 16 days it will be taken down and recycled.

The park's mid-19th-century founders would surely have approved these ideals; early advocates were especially keen that the picturesque woodlands and pathways should encourage poor people to avoid going to the saloon.

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Obituary

Ernst Mayr

Feb 10th 2005
From The Economist print edition

Corbis

Ernst Mayr, evolutionary biologist, died on February 3rd, aged 100

CHARLES DARWIN'S most famous book is called “On the Origin of Species by Means of Natural Selection”. That is not, however, what it is actually about. Natural selection is there in abundance. Darwin shows how small, heritable variations that improve survival and reproduction will accumulate over the millennia. He also shows that groups of similar species have descended from common ancestors. But on the origin of those species—exactly how one ancestral species divides into many—the book is largely silent.

Darwin did not know the answer to this question, and nor did anyone else until Ernst Mayr, a biologist working at the American Museum of Natural History in New York, enlightened them. First, in 1942, he published “Systematics and the Origin of Species”. This got to the heart of the problem by defining what a species actually is—not a group of individuals that look alike, but a group that can breed among themselves but not with others. That now-routine observation cleared the way to ask how such “reproductive isolation” comes about. Mr Mayr's answer was that bits of large interbreeding populations sometimes get isolated from the main (climate change may break up a range, for example). Natural selection will then do its work on the isolated sub-populations. To the extent that these sub-groups throw up different genetic mutations for selection to work on, and are subjected to different selective pressures, they will evolve in different directions. Eventually, they will become new species.

No doubt, many biologists reacted to this idea in the way that Thomas Henry Huxley reacted to Darwin's when he first heard it: “How extremely stupid not to have thought of that.” But it was Mr Mayr who did the thinking, and thus solved what Darwin and his contemporaries referred to as “the species problem”—in other words, why life on Earth is so diverse. By doing so, he joined a select group of biologists who, in the mid-20th century, rescued Darwin's idea from obfuscation

and misunderstanding. Huxley was known as “Darwin's bulldog” for his sturdy public defence of his reclusive friend's ideas. These biologists—Mr Mayr, Theodosius Dobzhansky and George Gaylord Simpson in particular—deserve, perhaps, to be known as Darwin's retrievers.

The neoDars

It was not that biologists had given up on evolution by the 1940s—quite the contrary. But they had got very confused about its mechanism. Darwin himself started the confusion in later editions of “On the Origin”, by retreating from natural selection as the sole mechanism of evolution, and even tinkering with the idea of the inheritance of acquired characteristics.

The geneticists of the early 20th century did not help. They rediscovered the laws of inheritance first developed 40 years earlier by Gregor Mendel, an unsung Moravian monk. They also discovered the idea of genetic mutation. But instead of linking these things to natural selection, they came up with the idea of “saltation”—in other words, sudden mutational shifts from one well-adapted species to another. Nor, the geneticists complained, had there been enough time for natural selection to do its work, given what they had discovered about the rate at which mutations occur, and the fact that most mutations are deleterious. It was all a bit of a mess.

Darwin's retrievers cut through this muddle. Dobzhansky integrated genetics into what became known as the neoDarwinian synthesis with his work on fruit flies. Simpson provided the palaeontology with a classic study of the evolution of horses. Mr Mayr's contribution was to tackle the question of speciation head-on and solve it. (The question of time was disposed of by physicists, who gave radioactive dating to the world, and thus showed it is billions of years old, and also donated nuclear fusion, which has kept the sun shining for those billions of years.)

Mr Mayr's advantage over the laboratory-bound biologists who had hijacked and diluted Darwin's legacy was that, like Darwin, he was a naturalist—and a good one. He identified 26 new species of bird, more than anyone else now alive, and 38 species of orchid. He was born in Bavaria and studied medicine, but found he preferred birdwatching. He arrived in America by a circuitous route that took in New Guinea, the Solomon Islands and Tring, a small town in southern England where Lord Rothschild, a rich naturalist, had established a private museum. He moved to New York when his patron had to sell his collection of bird specimens to the American Museum in order to pay off a blackmailer. Mr Mayr, who helped to broker the deal, relocated with the collection.

Mr Mayr did well in America, ending up in the Alexander Agassiz chair of zoology at Harvard, showered with honours, and proving the fitness of his own genes by living for more than a century. It is an irony, though, that his adopted country is the one place in the developed world where the neoDarwinian explanations that he and his colleagues created are not the commonplace of the schoolbooks, and where many people prefer to cling to the campfire tales of Genesis, rather than face the awesome thesis that Mr Mayr helped to elucidate.

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Overview

Feb 10th 2005
From The Economist print edition

America's labour market gained fewer jobs than expected in January. Non-farm payrolls rose by 146,000, compared with expectations of a rise by around 200,000. The unemployment rate fell to 5.2% in January, the lowest since September 2001, from 5.4% in December. December's payroll growth was revised down from 157,000 to 133,000.

The yield on 10-year **American government debt** fell to 3.98%, the first time it has dropped below 4.0% in three months.

The **euro** fell to a three-month low against the dollar of $1.27. **Sterling** fell to a two-month low of $1.86.

The **euro area's** 12-month rate of inflation was 2.1% in January, up from 1.9% a year ago. Industrial production rose by 0.9% in **Germany** and 1.3% in **Spain** in the year to December. Retail sales rose by 2.8% in **France** over the same period, and fell in **Italy** by 2.1% in the year to November.

In January unemployment was 7.0% in **Canada**, down from 7.3% a year ago, and rose slightly in **Switzerland**, to 4.1%.

Britain's industrial production rose by 0.5% in December. In the year to December, it was up by only 0.3%. The country's trade deficit narrowed by more than expected in December, to £4.4 billion ($8.5 billion).

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Output, demand and jobs

Feb 10th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		Unemployment % rate year ago
Australia	+ 3.0	Q3	+ 1.2	+ 3.4	+ 3.1	+ 4.2	Q3	+ 2.2	Q4	5.1	Jan	5.7
Austria	+ 2.7	Q3	+ 3.2	+ 1.7	+ 2.1	+ 8.5	Nov	+ 7.0	Nov	4.5	Jan	4.5
Belgium	+ 2.9	Q3	+ 3.2	+ 2.6	+ 2.1	+ 3.0	Nov	+ 4.5	Nov	12.7	Jan†	12.9
Britain	+ 2.8	Q4	+ 3.0	+ 3.0	+ 2.4	+ 0.3	Dec	+ 3.2	Dec	4.7	Nov††	4.9
Canada	+ 3.3	Q3	+ 3.2	+ 2.7	+ 3.0	+ 3.8	Nov	+ 5.0	Oct	7.0	Jan	7.3
Denmark	+ 1.8	Q3	+ 0.5	+ 2.0	+ 2.0	+ 4.1	Dec	+ 9.8	Dec	6.2	Dec	6.7
France	+ 1.9	Q3	– 0.1	+ 2.1	+ 1.9	+ 2.0	Dec	+ 2.8	Dec	9.9	Dec	9.9
Germany	+ 1.3	Q3	+ 0.4	+ 1.2	+ 1.3	+ 0.9	Dec	– 5.9	Dec	11.4	Jan§	10.2
Italy	+ 1.3	Q3	+ 1.7	+ 1.3	+ 1.4	– 2.8	Nov	– 2.1	Nov	7.7	Jun	8.6
Japan	+ 2.6	Q3	+ 0.2	+ 3.0	+ 1.6	+ 1.4	Dec	+ 0.3	Nov	4.4	Dec	4.9
Netherlands	+ 1.5	Q3	+ 1.3	+ 1.3	+ 1.3	– 0.7	Nov	– 0.6	Nov‡	6.5	Dec**	5.7
Spain	+ 2.6	Q3	+ 2.4	+ 2.4	+ 2.4	+ 1.3	Dec	+ 2.5	Dec	10.4	Dec	11.2
Sweden	+ 3.9	Q3	+ 3.8	+ 3.4	+ 2.9	+ 1.2	Nov	+ 4.8	Dec	5.3	Dec†	5.1
Switzerland	+ 1.8	Q3	+ 1.4	+ 1.7	+ 1.7	+ 3.5	Q3	+ 3.9	Nov	4.1	Jan†	4.3
United States	+ 3.7	Q4	+ 3.1	+ 4.3	+ 3.5	+ 4.4	Dec	+ 5.9	Dec	5.2	Jan	5.7
Euro area	+ 1.8	Q3	+ 1.1	+ 1.8	+ 1.6	+ 0.5	Nov	+ 0.5	Dec	8.9	Dec	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 3.2	Q3	+ 4.3	na	na	+12.0	Dec	+ 4.0	Nov	7.7	Dec†	8.2
Greece	+ 3.8	Q3	na	na	na	+ 2.8	Nov	+ 2.8	Nov	10.7	Mar	9.8
Iceland	+ 7.4	Q3	na	na	na	na		na		2.7	Dec†	3.4
Ireland	+ 5.8	Q3	na	na	na	–10.4	Nov	+ 4.2	Nov	4.2	Jan	4.4
Luxembourg	+ 2.1	2003	na	na	na	+ 2.4	Nov	+ 5.4	Nov	4.5	Dec	4.2
New Zealand	+ 4.0	Q3	+ 1.9	na	na	+ 4.5	Q3	+ 7.4	Q3	3.8	Q3	4.4
Norway	+ 1.8	Q3	– 3.9	na	na	– 0.5	Dec	+ 2.4	Dec	4.1	Jan‡	4.3
Portugal	+ 0.8	Q3	– 4.9	na	na	– 2.1	Dec	+ 5.2	Dec	6.8	Q3†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Sep-Nov; claimant count rate 2.7% in Dec. §EU harmonised rate 10.0% in Dec. **Oct-Dec.

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Prices and wages

Feb 10th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.6	Q4	+ 2.4	+ 2.3	+ 2.4	+ 8.2	Q4	– 1.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.9	Dec	+ 1.2	+ 2.0	+ 1.7	+ 4.7	Jan	+ 2.2	+ 2.0	Dec	+ 2.3
Belgium	+ 2.3	Jan	+ 1.6	+ 2.0	+ 1.8	+ 5.3	Dec	– 0.4	+ 2.4	Oct	+ 1.8
Britain	+ 1.6	Dec*	+ 1.3	+ 1.5	+ 1.7	+ 2.9	Dec	+ 1.8	+ 4.2	Nov†	+ 3.6
Canada	+ 2.1	Dec	+ 2.0	+ 1.9	+ 2.0	+ 3.8	Dec	– 3.5	+ 2.3	Oct	+ 3.2
Denmark	+ 1.0	Jan	+ 1.1	+ 1.1	+ 1.6	+ 2.7	Dec	+ 0.2	+ 2.9	Q3	+ 3.7
France	+ 2.1	Dec	+ 2.2	+ 2.2	+ 1.6	+ 3.0	Dec	+ 0.3	+ 2.7	Q3	+ 2.9
Germany	+ 1.6	Jan	+ 1.2	+ 1.7	+ 1.3	+ 3.8	Dec	+ 1.2	+ 0.3	Nov	+ 0.6
Italy	+ 1.9	Jan	+ 2.2	+ 2.2	+ 2.0	+ 4.2	Dec	+ 0.8	+ 3.3	Dec	+ 2.7
Japan	+ 0.2	Dec	– 0.4	nil	+ 0.3	+ 1.9	Dec	– 0.2	– 0.5	Dec	+ 3.0
Netherlands	+ 1.5	Jan	+ 1.3	+ 1.3	+ 1.2	+ 5.2	Dec	– 0.3	+ 0.7	Jan	+ 1.7
Spain	+ 3.2	Dec	+ 2.6	+ 2.8	+ 2.7	+ 5.0	Dec	+ 1.1	+ 2.2	Q3	+ 3.1
Sweden	+ 0.4	Dec	+ 1.4	+ 0.6	+ 1.3	+ 2.0	Dec	– 1.9	+ 2.4	Nov	+ 3.4
Switzerland	+ 1.2	Jan	+ 0.2	+ 0.9	+ 1.1	+ 1.5	Dec	– 0.2	+ 1.4	2003	+ 1.8
United States	+ 3.3	Dec	+ 1.9	+ 2.7	+ 2.4	+ 4.1	Dec	+ 3.7	+ 2.6	Jan	+ 2.0
Euro area	+ 2.1	Jan	+ 1.9	+ 2.1	+ 1.7	+ 3.6	Dec	+ 1.0	+ 2.0	Q3	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.4	Dec	+ 0.6	na	na	+ 0.7	Dec	– 0.4	+ 3.1	Q3	+ 4.3
Greece	+ 4.0	Jan	+ 2.9	na	na	+ 2.9	Dec	+ 2.1	na		na
Iceland	+ 4.0	Jan	+ 2.4	na	na	+ 8.6	Jan	+ 1.3	+ 6.0	Dec	+ 5.4
Ireland	+ 2.6	Dec	+ 1.9	na	na	– 1.6	Dec	– 9.1	+ 4.5	Q3	+ 4.6
Luxembourg	+ 2.2	Dec	+ 2.1	na	na	+15.7	Nov	+ 1.1	+ 2.5	Nov	na
New Zealand	+ 2.7	Q4	+ 1.6	na	na	+ 2.5	Q3	+ 0.1	+ 2.5	Q4	+ 2.3
Norway	+ 1.1	Dec	+ 0.6	na	na	+ 9.7	Dec	+ 0.7	+ 4.6	Q3	+ 4.2
Portugal	+ 2.5	Dec	+ 2.4	na	na	+ 4.7	Dec	nil	– 0.6	Dec	– 2.9

*New series. RPI inflation rate 3.5% in Dec. †Sep-Nov.

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Economic forecasts

Feb 10th 2005
From The Economist print edition

The Economist poll of forecasters, February averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2004	2005	2004	2005	2004	2005	2004	2005
Australia	2.3/3.6	2.5/3.8	3.4 (3.6)	3.1 (3.0)	2.3	2.4 (2.5)	–6.0	–5.4
Austria	1.5/2.0	1.4/2.3	1.7	2.1	2.0	1.7	–0.6	–0.7
Belgium	2.0/2.7	1.3/2.5	2.6 (2.5)	2.1	2.0 (2.1)	1.8 (1.7)	3.7 (3.6)	3.5 (3.4)
Britain	2.6/3.2	2.0/3.1	3.0 (3.2)	2.4	1.5	1.7	–2.3(–2.4)	–2.6
Canada	2.5/3.0	2.5/3.5	2.7 (2.8)	3.0 (3.1)	1.9	2.0 (2.1)	2.7 (2.8)	2.1 (2.2)
Denmark	1.5/2.2	1.5/2.5	2.0 (2.1)	2.0	1.1 (1.2)	1.6	2.9	2.8 (2.6)
France	1.7/2.2	1.3/2.2	2.1	1.9 (1.8)	2.2	1.6	nil (0.1)	0.1
Germany	1.1/1.7	0.9/1.7	1.2 (1.3)	1.3 (1.2)	1.7 (1.8)	1.3	3.0 (3.1)	3.0 (2.9)
Italy	1.1/1.4	0.8/1.8	1.3 (1.2)	1.4 (1.5)	2.2 (2.3)	2.0	–0.9(–0.8)	–1.0 (–0.9)
Japan	1.8/4.0	0.5/3.0	3.0 (3.2)	1.6	nil (–0.1)	0.3 (nil)	3.6 (3.3)	3.5 (3.4)
Netherlands	1.2/1.4	0.7/2.5	1.3 (1.2)	1.3 (1.2)	1.3	1.2	3.0	3.1 (3.0)
Spain	1.2/2.7	1.5/2.7	2.4 (2.6)	2.4	2.8 (3.0)	2.7 (2.8)	–3.1(–3.7)	–3.4 (–3.9)
Sweden	2.8/4.0	2.4/3.3	3.4	2.9 (2.8)	0.6 (0.7)	1.3 (1.5)	6.4 (7.6)	5.7 (6.7)
Switzerland	1.4/2.0	1.2/2.0	1.7 (1.8)	1.7 (1.8)	0.9 (0.8)	1.1 (1.2)	12.5(12.4)	12.1 (11.9)
United States	3.2/4.4	3.1/4.1	4.3 (4.4)	3.5	2.7	2.4	–5.6(–5.5)	–5.9 (–5.6)
Euro area	1.5/1.9	1.3/2.0	1.8	1.6	2.1	1.7 (1.8)	0.5	0.6 (0.5)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, J.P. Morgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month, *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel is sticking to its forecasts that the United States will grow in 2005 by 3.5%, whereas the euro area will grow by only 1.6%. However, it has become gloomier about the outlook for the American current-account deficit, which it expects to reach 5.9% of GDP this year, up from 5.6% in January. The panel has shaved its forecast for consumer-price inflation in the euro area in 2005 to 1.7%, down from 1.8% last month. It thinks that consumer prices will rise this year by 2.4% in the United States.

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Money and interest rates

Feb 10th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Feb 9th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 2.6	+ 9.2	Dec	5.57	5.55	5.33	5.29	5.61	6.20
Britain	+ 5.8	+ 8.6	Dec	4.84	4.13	4.55	4.47	4.75	5.24
Canada	+11.2	+10.4	Dec	2.46	2.22	2.89	4.18	4.39	5.65
Denmark	+14.4	+12.7	Dec	2.19	2.15	2.42	3.50	4.25	4.98
Japan	+ 4.2	+ 2.0	Jan	0.02	0.03	0.11	1.37	1.26	1.39
Sweden	– 0.2	+ 4.6	Dec	1.97	2.46	2.17	3.60	4.50	2.20
Switzerland	– 5.3	+ 1.2	Dec	0.75	0.25	0.97	1.96	2.39	2.08
United States	+ 5.4	+ 6.2	Dec	2.60	1.01	3.25	3.97	4.02	5.17
Euro area†	+ 8.4	+ 6.4	Dec	2.14	2.07	2.39	3.41	4.09	3.63

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.77%, Japan No. 267 1.37%. Central bank rates: US fed funds 2.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 10th 2005
From The Economist print edition

2000=100

	Feb 1st	Feb 8th*	% change on one month	% change on one year
Dollar index				
All items	125.7	125.8	+ 0.6	– 4.2
Food	116.8	118.0	– 0.0	–10.1
Industrials				
All	137.2	135.9	+ 1.3	+ 3.3
Nfa†	125.9	127.5	+ 4.6	–10.4
Metals	143.4	140.5	– 0.3	+11.8
Sterling index				
All items	101.4	102.8	+ 1.7	– 3.8
Euro index				
All items	89.4	91.1	+ 3.6	– 4.8
Yen index				
All items	121.4	123.5	+ 2.5	– 4.0
Gold				
$ per oz	420.10	412.30	– 2.3	+ 0.9
West Texas Intermediate				
$ per barrel	47.16	45.42	– 0.8	+33.9

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 10th 2005
From The Economist print edition

Market indices

		2004-05		% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
	Feb 9th	high	low				
Australia (All Ordinaries)	4,163.2	4,182.9	3,274.9	+ 0.5	– 0.5	+25.9	+28.4
Austria (ATX)	2,580.3	2,580.3	1,568.9	+ 2.3	nil	+67.0	+69.3
Belgium (Bel 20)	3,085.1	3,085.1	2,244.2	+ 1.9	–16.2	+37.5	+39.4
Britain (FTSE 100)	4,990.4	4,995.5	4,287.0	+ 1.5	–28.0	+11.5	+15.7
Canada (Toronto Composite)	9,402.6	9,402.6	8,123.5	+ 1.1	–17.4	+14.4	+18.3
Denmark (KBX)	271.6	271.6	219.0	+ 1.7	–10.0	+27.2	+29.0
France (SBF 250)	2,752.5	2,759.0	2,386.1	+ 0.6	–37.3	+14.1	+15.7
(CAC 40)	3,969.6	3,981.9	3,465.3	+ 0.5	–42.7	+11.6	+13.1
Germany (DAX)	4,353.2	4,371.4	3,647.0	+ 1.3	–46.0	+ 9.8	+11.3
Italy (BCI)	1,550.1	1,550.1	1,239.5	+ 1.7	–29.0	+23.4	+25.1
Japan (Nikkei 225)	11,473.4	12,163.9	10,365.4	+ 0.6	–70.5	+ 7.5	+ 8.9
(Topix)	1,155.8	1,217.9	1,022.6	+ 0.3	–59.9	+10.7	+12.2
Netherlands (AEX)	368.4	369.1	310.7	+ 0.8	–47.5	+ 9.1	+10.6
Spain (Madrid SE)	1,007.4	1,009.8	804.4	+ 1.5	–12.1	+24.7	+26.4
Sweden (Affarsvarlden Gen)	231.2	231.2	188.5	+ 2.1	–42.2	+22.7	+24.6
Switzerland (Swiss Market)	5,866.5	5,934.4	5,309.7	+ 1.2	–30.3	+ 6.9	+ 8.6
United States (DJIA)	10,664.1	10,854.5	9,750.0	+ 0.6	– 9.0	+ 2.0	+ 2.0
(S&P 500)	1,192.0	1,213.6	1,063.2	– 0.1	–22.0	+ 7.2	+ 7.2
(NASDAQ Comp)	2,052.6	2,178.3	1,752.5	– 1.1	–59.3	+ 2.5	+ 2.5
Europe (FTSEurofirst 300)*	1,088.2	1,088.2	940.9	+ 1.4	–36.2	+13.6	+15.2
Euro area (FTSE Euro 100)*	931.6	934.5	787.2	+ 0.9	–39.9	+12.0	+13.6
World (MSCI)†	1,149.1	1,170.0	997.0	– 0.3	–20.7	+10.9	+10.9
World bond market (Citigroup)‡	649.9	666.7	575.1	– 1.0	– 2.5	+ 7.7	+ 7.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 10th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Feb 9th	year ago	Currency units per $ Feb 9th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 18.0	Dec	− 36.2	Q3	− 6.0	− 5.4	87.6	89.6	1.30	1.28	2.42	1.66	1.23	+ 0.7
Austria	+ 0.5	Nov	− 1.8	Nov	− 0.6	− 0.7	103.4§	102.8	0.78	0.79	1.45	–	0.74	− 1.5
Belgium	+ 21.4	Nov	+ 11.7	Sep	+ 3.7	+ 3.5	104.0§	102.9	0.78	0.79	1.45	–	0.74	− 0.1
Britain	−105.5	Dec	− 47.4	Q3	− 2.3	− 2.6	103.0	104.6	0.54	0.54	–	0.69	0.51	− 3.2
Canada	+ 52.8	Nov	+ 26.7	Q3	+ 2.7	+ 2.1	92.1	86.0	1.25	1.33	2.32	1.60	1.18	+ 1.1
Denmark	+ 9.5	Nov	+ 5.9	Nov	+ 2.9	+ 2.8	107.0	107.0	5.82	5.88	10.8	7.44	5.50	+ 0.9
France	− 6.0	Nov	− 3.4	Nov	nil	+ 0.1	107.6§	106.3	0.78	0.79	1.45	–	0.74	− 3.7
Germany	+194.2	Dec	+ 96.0	Dec	+ 3.0	+ 3.0	105.4§	103.9	0.78	0.79	1.45	–	0.74	− 3.9
Italy	+ 0.3	Nov	− 12.0	Nov	− 0.9	− 1.0	76.7§	75.8	0.78	0.79	1.45	–	0.74	− 2.9
Japan	+131.7	Nov	+167.7	Nov	+ 3.6	+ 3.5	137.7	137.2	105	106	196	135	–	− 6.5
Netherlands	+ 36.6	Nov	+ 21.0	Q3	+ 3.0	+ 3.1	103.6§	102.3	0.78	0.79	1.45	–	0.74	− 2.9
Spain	− 72.5	Nov	− 43.3	Oct	− 3.1	− 3.4	77.8§	77.0	0.78	0.79	1.45	–	0.74	− 1.1
Sweden	+ 22.9	Dec	+ 26.2	Q3	+ 6.4	+ 5.7	82.6	81.9	7.09	7.22	13.2	9.07	6.71	+ 0.5
Switzerland	+ 8.0	Dec	+ 44.7	Q3	+12.5	+12.1	112.7	110.8	1.22	1.24	2.26	1.56	1.15	− 1.6
United States	−653.8	Nov	−603.2	Q3	− 5.6	− 5.9	91.2	94.4	–	–	1.86	1.28	0.95	− 4.4
Euro area	+ 93.9	Nov	+ 48.3	Nov	+ 0.5	+ 0.6	93.0	92.1	0.78	0.79	1.45	–	0.74	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.8	Nov	+ 6.9	Nov	na	na	82.7§	81.6	0.78	0.79	1.45	–	0.74	+ 2.3
Greece	− 31.2	Nov	− 10.0	Nov	na	na	60.0§	59.4	0.78	0.79	1.45	–	0.74	− 5.3
Iceland	− 0.8	Nov	− 0.6	Q3	na	na	96.1**	93.0	63.3	68.6	118	80.9	59.8	+ 0.1
Ireland	+ 41.8	Nov	− 1.6	Q3	na	na	96.3§	94.5	0.78	0.79	1.45	–	0.74	+ 0.2
Luxembourg	− 4.4	Nov	+ 2.3	Q3	na	na	104.0§	102.9	0.78	0.79	1.45	–	0.74	− 0.4
New Zealand	− 2.8	Dec	− 5.3	Q3	na	na	108.1	106.9	1.43	1.44	2.66	1.83	1.35	+ 2.9
Norway	+ 34.0	Dec	+ 33.8	Nov	na	na	98.2	91.2	6.55	6.99	12.2	8.38	6.19	+ 8.2
Portugal	− 18.5	Nov	− 12.6	Nov	na	na	93.7**	93.2	0.78	0.79	1.45	–	0.74	− 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate. ††New series.
**IMF, September average.

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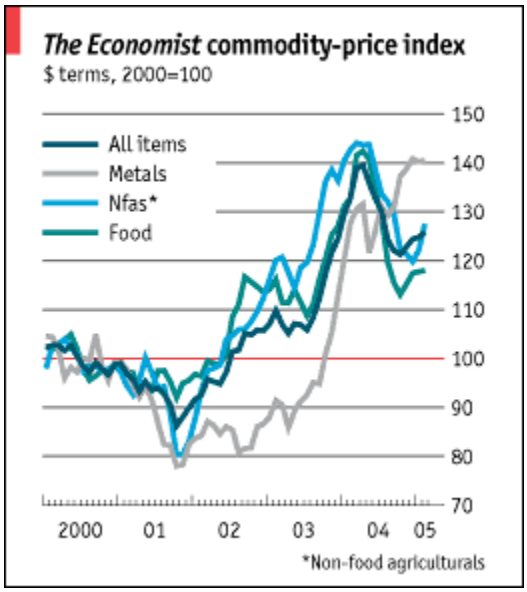
The Economist commodity-price index

Feb 10th 2005
From The Economist print edition

Our index has been re-based to the year 2000 (see article). The all-items dollar-based index has fallen by 11% since March, but it remains 47% above its low in October 2001.



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Overview

Feb 10th 2005
From The Economist print edition

China's trade surplus widened to $38.4 billion in the 12 months to January, up from $26.8 billion a year earlier.

The inflation rate in **Turkey** fell to 9.2% in January, down from 16.2% a year earlier. But the country's current-account deficit widened to a record $15.6 billion in 2004.

In January, the 12-month rate of inflation fell to 0.5% in **Taiwan** and to 2.2% in **Chile**.

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Exchange rates against the dollar

Feb 10th 2005
From The Economist print edition

Since the beginning of 2004, every currency in our chart rose against the dollar, except for the Indonesian rupiah, which slid by nearly 9%. Poland's zloty climbed by 21%, more than any other currency. Other emerging-market currencies also made big gains. Colombia's peso, South Korea's won and Brazil's *real* all rose by more than 10%. During the same period, the euro rose by just 2% and the yen by 3%. The currencies of Argentina and Mexico rose only modestly.

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Economy

Feb 10th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q4	+14.4	Dec	+ 2.4	Dec	+38.4	Jan	+45.9	2003	609.9	Dec
Hong Kong	+ 7.2	Q3	+ 3.4	Q3	+ 0.2	Dec	–12.1	Dec	+14.2	Q3	124.7	Jan
India	+ 6.6	Q3	+ 7.9	Nov	+ 3.8	Dec	–22.2	Dec	+ 3.5	Q3	123.7	Jan
Indonesia	+ 5.0	Q3	– 2.3	Aug	+ 7.3	Jan	+24.1	Dec	+ 4.0	Q3	35.0	Dec
Malaysia	+ 6.8	Q3	+ 5.8	Dec	+ 2.1	Dec	+21.3	Dec	+14.7	Q3	65.9	Dec
Philippines	+ 5.4	Q4	+ 8.7	Nov	+ 7.9	Dec	– 0.8	Nov	+ 4.4	Sep	12.9	Jan
Singapore	+ 5.4	Q4	+31.7	Dec	+ 1.5	Dec	+15.8	Dec	+29.0	Q3	112.8	Dec
South Korea	+ 4.6	Q3	+ 4.5	Dec	+ 3.1	Jan	+30.2	Jan	+27.6	Dec	199.6	Jan
Taiwan	+ 5.3	Q3	– 0.9	Dec	+ 0.5	Jan	+ 6.1	Dec	+24.8	Q3	242.7	Jan
Thailand	+ 6.0	Q3	+ 3.0	Dec	+ 2.7	Jan	+ 1.7	Dec	+ 7.3	Dec	48.7	Dec
Argentina	+ 8.3	Q3	+ 5.4	Nov	+ 6.1	Dec	+12.1	Dec	+ 3.6	Q3	20.1	Jan
Brazil	+ 6.1	Q3	+ 8.1	Nov	+ 7.6	Dec	+34.3	Jan	+10.7	Nov	52.9	Dec
Chile	+ 6.8	Q3	+ 9.9	Nov	+ 2.2	Jan	+ 8.9	Dec	+ 2.0	Q3	16.0	Dec
Colombia	+ 2.4	Q3	+ 5.6	Nov	+ 5.4	Jan	+ 0.9	Oct	– 1.4	Q3	12.2	Dec
Mexico	+ 4.4	Q3	+ 5.4	Nov	+ 4.5	Jan	– 8.1	Dec	– 5.5	Q3	63.7	Nov
Peru	+ 8.4	Nov	+10.8	Nov	+ 3.0	Jan	+ 2.5	Nov	– 0.3	Q3	12.3	Jan
Venezuela	+15.8	Q3	+14.7	Oct	+18.5	Jan	+21.5	Q3	+14.4	Q3	17.2	Oct
Egypt	+ 4.7	Q4	+ 3.3	2004†	+11.7	Nov	– 8.1	Q3	+ 4.1	Q3	13.5	Sep
Israel	+ 2.9	Q3	+13.7	Nov	+ 1.2	Dec	– 6.8	Dec	+ 0.5	Q3	27.1	Jan
South Africa	+ 3.8	Q3	+ 7.8	Dec	+ 3.4	Dec	– 1.9	Dec	– 4.7	Q3	13.4	Jan
Turkey	+ 4.5	Q3	+ 4.7	Dec	+ 9.2	Jan	–34.5	Dec	–15.6	Dec	36.0	Dec
Czech Republic	+ 3.6	Q3	+10.9	Nov	+ 1.7	Jan	– 0.8	Dec	– 6.4	Q3	27.8	Jan
Hungary	+ 3.7	Q3	+ 1.4	Dec	+ 5.5	Dec	– 2.5	Q3	– 8.6	Q3	15.0	Jan
Poland	+ 4.8	Q3	+ 6.4	Dec	+ 4.4	Dec	– 6.1	Nov	– 3.0	Dec	35.3	Dec
Russia	+ 6.4	Q3	+ 4.8	Dec	+12.7	Jan	+87.0	Dec	+49.5	Q3	121.2	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.1	Q3	+ 5.0	Dec	+ 4.2	Jan	– 2.7	Nov	– 1.5	Q3	1.6	Nov
Latvia	+ 9.1	Q3	+ 6.0	Nov	+ 6.6	Jan	– 2.7	Nov	– 1.7	Nov	1.8	Nov
Lithuania	+ 6.4	Q4	na		+ 2.9	Dec	– 3.2	Nov	– 2.0	Q3	3.6	Nov
Slovakia	+ 5.3	Q3	+ 0.4	Dec	+ 5.9	Dec	– 1.2	Nov	– 0.9	Sep	13.4	Nov
Slovenia	+ 4.9	Q3	+ 6.3	Dec	+ 2.2	Jan	– 1.5	Nov	– 0.1	Nov	8.2	Oct
Pakistan	+ 6.4	2004†	+12.1	Sep	+ 7.4	Dec	– 5.0	Dec	+ 0.8	Q3	9.8	Dec
Saudi Arabia	+ 7.2	2003	na		+ 0.6	Nov	+59.1	2003	+28.0	2003	23.6	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Financial markets

Feb 10th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 9th		Dec 31st 2003	
	Feb 9th	year ago	Feb 9th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.4	3.30	1,332.4	+1.3	– 15.1	– 15.1
Hong Kong	7.80	7.77	14.5	1.28	13,845.6**	+2.1	+ 10.1	+ 9.6
India	43.7	45.2	81.2	5.31	6,593.5	+1.0	+ 12.9	+ 17.9
Indonesia	9,290	8,415	17,258	7.56	1,036.6	– 1.5	+ 49.8	+ 35.8
Malaysia	3.80	3.80	7.06	2.82	914.9	– 0.4	+ 15.2	+ 15.2
Philippines	54.9	55.9	102.0	6.00	2,028.9	+2.0	+ 40.7	+ 42.3
Singapore	1.65	1.67	3.07	1.81	2,140.2	+1.5	+ 21.3	+ 24.8
South Korea	1,037	1,161	1,926	3.58	949.2	+3.0	+ 17.1	+ 34.6
Taiwan	31.9	33.1	59.2	1.35	6,034.6	+0.3	+ 2.4	+ 9.1
Thailand	38.6	38.9	71.8	2.50	735.6	+3.6	– 4.7	– 2.3
Argentina	2.91	2.94	5.40	4.44	1,484.6	+8.3	+ 38.5	+ 39.6
Brazil	2.61	2.92	4.84	18.24	26,313.5	+6.9	+ 18.3	+ 31.0
Chile	579	583	1,075	3.00	8,924.0	+0.9	+ 21.6	+ 24.6
Colombia	2,357	2,736	4,379	7.64	4,757.9	+3.9	+103.9	+140.4
Mexico	11.2	11.0	20.8	9.14	13,662.4	+2.4	+ 55.3	+ 55.8
Peru	3.26	3.49	6.05	2.83	3,820.7	– 1.5	+ 56.9	+ 66.8
Venezuela	2,763§	2,988§	5,132	12.59	29,704.6	nil	+ 33.8	+ 38.1
Egypt	5.81	6.18	10.80	9.90	30,752.8	– 4.2	+164.3	+180.3
Israel	4.38	4.48	8.14	1.00	664.8	– 0.1	+ 24.4	+ 24.7
South Africa	6.24	6.87	11.6	7.55	13,107.5	+1.2	+ 26.2	+ 35.0
Turkey	1.35	1.33	2.51	19.78	27,528.1	– 1.5	+ 47.8	+ 54.5
Czech Republic	23.4	25.7	43.4	2.25	1,121.1	+1.7	+ 70.1	+ 86.7
Hungary	191	207	355	8.55	16,464.8	+6.5	+ 75.5	+ 90.6
Poland	3.13	3.82	5.81	6.60	26,719.8	+1.9	+ 28.3	+ 53.6
Russia	28.1	28.5	52.2	13.00	656.6‡	+0.9	+ 11.3	+ 15.7
EMF (MSCI)*	1.00	1.00	1.86	na	551.9	+1.6	+ 24.7	+ 24.7
EMBI+†	1.00	1.00	1.86	na	337.2	+1.7	+ 14.4	+ 14.4

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **Feb 8th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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